

**RAO UES GROUP**  
**IFRS CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2003**



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## Independent Auditor's Report

Board of Directors  
OAO RAO UES of Russia

We have audited the accompanying consolidated balance sheet of OAO RAO UES of Russia and its subsidiaries (the "Group") as of 31 December 2003 and the related consolidated statements of operations, changes in shareholders' equity and cash flows for the year then ended. These consolidated financial statements, as set out on pages 2 to 33, are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audit. The consolidated financial statements of the Group for the year ended 31 December 2002 were audited by another auditor whose report dated 6 June 2003 expressed an unqualified opinion on those statements.

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

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2003, and the results of its operations, changes in shareholders' equity and cash flows for the year then ended in accordance with International Financial Reporting Standards promulgated by the International Accounting Standards Board.

*ZAO KPMG*

ZAO KPMG  
Moscow, Russian Federation  
5 July 2004



# RAO UES Group

## Consolidated Balance Sheet as at 31 December 2003

(in millions of Russian Roubles)

	Notes	31 December 2003	31 December 2002
<b>Assets</b>			
<b>Non-current assets</b>			
Property, plant and equipment	8	872,179	863,688
Investments in associates	7	196	-
Deferred profit tax assets	15	3,881	9,122
Other non-current assets	9, 5	26,200	25,342
<b>Total non-current assets</b>		<b>902,456</b>	<b>898,152</b>
<b>Current assets</b>			
Cash and cash equivalents	10	31,978	17,569
Accounts receivable and prepayments	11	105,340	92,971
Inventories	12	42,731	38,383
Loans issued		-	2,635
Other current assets	5	5,036	11,726
<b>Total current assets</b>		<b>185,085</b>	<b>163,284</b>
<b>Total assets</b>	6	<b>1,087,541</b>	<b>1,061,436</b>
<b>Shareholders' equity and liabilities</b>			
<b>Shareholders' equity</b>			
Share capital			
Ordinary shares (nominal value RR 20,521 million)		147,439	147,439
Preference shares (nominal value RR 1,038 million)		7,667	7,667
Treasury shares		(355)	(770)
		154,751	154,336
Retained earnings and fair value reserve		432,553	412,079
<b>Total shareholders' equity</b>		<b>587,304</b>	<b>566,415</b>
<b>Minority interest</b>	14	<b>219,687</b>	<b>223,981</b>
<b>Non-current liabilities</b>			
Deferred profit tax liabilities	15	57,895	54,608
Non-current debt	16	12,556	13,461
Other non-current liabilities	17	24,202	26,872
<b>Total non-current liabilities</b>		<b>94,653</b>	<b>94,941</b>
<b>Current liabilities</b>			
Current debt and current portion of non-current debt	18	50,496	42,236
Accounts payable and accrued charges	19	89,758	84,337
Taxes payable	20	45,643	49,526
<b>Total current liabilities</b>		<b>185,897</b>	<b>176,099</b>
<b>Total liabilities</b>	6	<b>280,550</b>	<b>271,040</b>
<b>Total shareholders' equity and liabilities</b>		<b>1,087,541</b>	<b>1,061,436</b>

Deputy Chairman of the Management Board

Urinson J.M.

Financial Director

Zhurba D.G.

5 July 2004



# RAO UES Group

## Consolidated Statement of Operations for the year ended 31 December 2003

(in millions of Russian Roubles)

	Notes	Year ended 31 December 2003	Year ended 31 December 2002
<b>Revenues</b>			
Electricity		448,043	377,766
Heating		100,117	87,946
Governmental assistance	21	5,200	5,370
Other		39,789	32,327
<b>Total revenues</b>	<b>6</b>	<b>593,149</b>	<b>503,409</b>
<b>Costs and other deductions</b>			
Fuel expenses		161,251	133,579
Wages, benefits and payroll taxes		96,172	88,290
Purchased power		70,312	61,439
Depreciation	8	61,771	59,171
Repairs and maintenance		41,936	37,056
Taxes other than on income		13,371	23,995
Other materials		13,313	14,736
Electricity and heat distribution		6,081	4,491
Water usage expenses		4,578	3,988
Insurance expense		4,552	3,115
Social expenditures		3,193	5,299
Doubtful debtors (release) / expense		(1,536)	12,113
Loss / (gain) on disposal of property, plant and equipment and investments		1,873	(150)
Other expenses		51,805	37,987
<b>Total costs and other deductions</b>		<b>528,672</b>	<b>485,109</b>
<b>Income from operations</b>	<b>6</b>	<b>64,477</b>	<b>18,300</b>
Share of (loss) / income of associates		(54)	237
Monetary effects and financing items	22	(15,387)	(3,973)
<b>Income before profit tax and minority interest</b>		<b>49,036</b>	<b>14,564</b>
Total profit tax (charge) / benefit	15	(24,754)	24,283
<b>Income before minority interest</b>		<b>24,282</b>	<b>38,847</b>
Minority interest: share of net result	14	2,701	(3,853)
<b>Net income</b>		<b>26,983</b>	<b>34,994</b>
<b>Earnings per ordinary and preference share – basic and diluted (in Russian Roubles)</b>	<b>23</b>	<b>0.63</b>	<b>0.82</b>

Deputy Chairman of the Management Board

Urinson J.M.

Financial Director

Zhurba D.G.

5 July 2004



**RAO UES Group****Consolidated Cash Flow Statement for the year ended 31 December 2003**

(in millions of Russian Roubles)

	Year ended 31 December 2003	Year ended 31 December 2002
<b>CASH FLOW FROM OPERATING ACTIVITIES:</b>		
<b>Income before profit tax</b>	<b>49,036</b>	<b>14,564</b>
Adjustments to reconcile income before profit tax to net cash provided by operations:		
Depreciation	61,771	59,171
Doubtful debtors (release) / expense	(1,536)	12,113
Interest and gain on restructuring accounts payable and taxes payable	16,947	11,318
Share of loss / (income) of associates, before profit tax	54	(237)
Loss / (gain) on disposal of property, plant and equipment and investments	1,873	(150)
Monetary effects on non-operating balances	-	(4,624)
Adjustment for non-cash investing activities	(10,229)	(9,851)
Other	(2)	7
<b>Operating cash flows before working capital changes and profit tax paid</b>	<b>117,914</b>	<b>82,311</b>
Working capital changes:		
Increase in accounts receivable and prepayments	(9,356)	(1,165)
Decrease / (increase) in other current assets	6,738	(6,243)
Decrease in loans issued	2,635	12,705
(Increase) / decrease in inventories	(4,093)	4,704
(Increase) / decrease in other non-current assets	(3,458)	6,398
Increase / (decrease) in accounts payable and accrued charges	4,864	(17,769)
Decrease in taxes payable, other than profits tax	(13,707)	(4,539)
(Decrease) / increase in other non-current liabilities	(3,882)	1,579
Profit tax paid (cash)	(16,389)	(19,086)
Profit tax paid (non-cash)	(233)	(390)
<b>Net cash provided by operating activities</b>	<b>81,033</b>	<b>58,505</b>
<b>CASH FLOW FROM INVESTING ACTIVITIES:</b>		
Additions to property, plant and equipment	(64,338)	(40,830)
Proceeds from sale of property, plant and equipment	3,974	2,221
Purchases of investments, net	(554)	(429)
Acquisition of subsidiaries, net of cash acquired	(651)	-
<b>Net cash used for investing activities</b>	<b>(61,569)</b>	<b>(39,038)</b>
<b>CASH FLOW FROM FINANCING ACTIVITIES:</b>		
Proceeds from issuance of current debt	163,783	135,459
Proceeds from issuance of non-current debt	2,900	9,688
Repayment of debt	(162,124)	(147,822)
Interest paid	(7,550)	(9,094)
Dividends paid to RAO UES shareholders	(2,028)	(1,347)
Dividends paid by Group to minority interest shareholders	(1,938)	(1,942)
Proceeds from share issuance	456	899
Proceeds from / (purchase) of treasury shares, net	1,446	(8)
<b>Net cash used for financing activities</b>	<b>(5,055)</b>	<b>(14,167)</b>
Effect of inflation on cash and cash equivalents	-	(2,284)
<b>Increase in cash and cash equivalents</b>	<b>14,409</b>	<b>3,016</b>
<b>Cash and cash equivalents at the beginning of the period</b>	<b>17,569</b>	<b>14,553</b>
<b>Cash and cash equivalents at the end of the period</b>	<b>31,978</b>	<b>17,569</b>

Deputy Chairman of the Management Board

Financial Director



Urinson J.M.

Zhurba D.G.

5 July 2004

**RAO UES Group****Consolidated Statement of Changes in Shareholders' Equity for the year ended 31 December 2003**

(in millions of Russian Roubles)

	Ordinary share capital	Preference share capital	Treasury shares	Retained earnings and fair value reserve	Total shareholders' equity
<b>At 1 January 2002</b>	147,439	7,667	(762)	379,596	533,940
Net income	-	-	-	34,994	34,994
Dividends	-	-	-	(1,385)	(1,385)
Change in fair value of available-for-sale investments	-	-	-	(1,126)	(1,126)
Change in treasury shares, net	-	-	(8)	-	(8)
<b>At 31 December 2002</b>	147,439	7,667	(770)	412,079	566,415
<b>At 1 January 2003</b>	147,439	7,667	(770)	412,079	566,415
Net income	-	-	-	26,983	26,983
Dividends	-	-	-	(1,988)	(1,988)
Change in fair value of available-for-sale investments	-	-	-	(4,897)	(4,897)
Change in treasury shares, net	-	-	415	726	1,141
Translation differences	-	-	-	(350)	(350)
<b>At 31 December 2003</b>	147,439	7,667	(355)	432,553	587,304

Deputy Chairman of the Management Board

Urinson J.M.

Financial Director

Zhurba D.G.

5 July 2004



## RAO UES Group

### Notes to the Consolidated Financial Statements for the year ended 31 December 2003

(in millions of Russian Roubles)

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#### Note 1: The Group and its operations

The Russian Open Joint Stock Company for Energy and Electrification Unified Energy System of Russia ("RAO UES") was created on 31 December 1992 following the privatisation of certain electricity power generation, transmission and distribution assets formerly under the control of the Ministry of Energy of the Russian Federation. Nuclear generation stations were not transferred to RAO UES.

The RAO UES Group (the "Group") consists of RAO UES and its related subsidiaries and associates as at 31 December 2003. Principal subsidiaries are disclosed in Note 5. The operations of all generating facilities are coordinated by the Central Dispatch Centre ("CDC") and Regional Dispatch Centres, which are all under the control of the Group, in order to meet system requirements in an efficient manner.

All member companies of the Group with the exception of foreign subsidiaries are incorporated under the laws of the Russian Federation (the "state"). The principal foreign subsidiaries are disclosed in Note 5.

The Group performs the following major activities:

- **High voltage transmission:** The high voltage transmission network connects all but a few regions of the Russian Federation. RAO UES charges a transmission fee to users of the network and, together with the Federal Grid Company (a 100 percent owned subsidiary of RAO UES), maintains this network. The CDC, a 100 percent owned subsidiary of RAO UES, is responsible for system dispatch and the functioning of the Federal Wholesale Market of Electricity and Capacity ("FOREM");
- **Regional generation and distribution:** RAO UES has ownership interests in more than 70 regional power companies ("Energos"), responsible for the generation, distribution and sale of heat and electricity. These ownership interests range from 47 percent to 100 percent; and
- **Stand-alone electricity generation:** Major generation stations produce electricity and sell it via FOREM. The majority of these sales are within the Group.

At 31 December 2003, the number of employees of the Group was approximately 557,000 (31 December 2002: 599,000).

RAO UES's registered office is located at bld. 3, 101 Vernadskogo prospect, 119526, Moscow, Russia.

RAO UES also prepares annual parent company stand-alone financial statements in accordance with International Financial Reporting Standards ("IFRS").

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

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

**Relations with the state and current regulation.** At 31 December 2003, the Russian Federation owned 52.7 percent of RAO UES, which represents 55.0 percent of the ordinary shares issued. As discussed in Note 13, only ordinary shares have voting rights. The Group's customer base includes a large number of entities controlled by, or related to, the state. Furthermore, the state controls a number of the Group's fuel and other suppliers.

The government of the Russian Federation directly affects the Group's operations through regulation by the Federal Energy Commission ("FEC"), with respect to its wholesale energy sales, and by the Regional Energy Commissions ("RECs"), with respect to its retail electricity and heat sales. Tariffs which Group entities may charge for sales of electricity and heat are governed both by regulations specific to the electricity and heat industry and by regulations applicable to natural monopolies. As a condition to privatisation in 1992, the government of the Russian Federation imposed an obligation on Group entities to provide connection for the supply of electricity and heating to customers in the Russian Federation.

## RAO UES Group

### Notes to the Consolidated Financial Statements for the year ended 31 December 2003

(in millions of Russian Roubles)

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#### Note 1: The Group and its operations (continued)

As described above and in Notes 2 and 25, the government's economic, social and other policies could have material effects on the operations of the Group.

**Regulatory issues and sector restructuring.** The Russian electric utilities industry in general and the Group in particular are presently undergoing a reform process designed to introduce competition into the electricity sector and to create an environment in which the Group and its successor companies can raise the capital required to maintain and expand current capacity. The regulatory framework governing the process of reforming the Russian Federation electric utilities industry and the functioning of the industry, both during the transition period and subsequent to the completion of reforms, is set forth in the following legislation: Federal Law No.35-FZ of 26 March 2003 "On the Electric Utilities of the Russian Federation" and Federal Law No.36-FZ of 26 March 2003 "On the Specifics of the Functioning of Electric Utilities During the Transition Period and the Introduction of Amendments to Certain Russian Federation Legislative Acts and the Invalidation of Certain Russian Federation Legislative Acts in Connection with the Adoption of the Law "On the Electric Utilities of the Russian Federation".

- In April 2003, legislation underlying the electric utilities reform effort took effect. This legislative package, consisting of six laws drafted by the Russian Federation government, defines the key areas in the industry reform program, as well as the terms and conditions under which electric utilities will function both during the transition period and following the reforms.
- At the present stage, bills are being drafted for the specific legislative acts envisioned under the aforementioned laws on electric utilities reform according to the action plan related to electric utilities reform and adopted by the resolution of the Russian Federation government of 27 June 2003 No 865-r (p). RAO UES has been playing an active role in drafting these parts of legislation.
- Early September 2003 the Russian Federation government issued Resolution No. 1254-r (p) approving the structures of generating companies in the wholesale electricity market. According to the aforementioned resolution 10 generating companies (4 – based on hydro generating power plants and 6 based on heat generating power plants), which will include the electric power plants owned by OAO RAO UES and its subsidiaries, will be established.
- In October 2003, the Russian Federation government issued Resolution No. 643 "On the Rules for the Wholesale Electricity (Power) Market during the Transition Period". According to the rules adopted, there will be two sectors within the Federal Wholesale Electricity (Power) Market: regulated trading sector and free trading sector. Within the free trading sector, electricity suppliers will be able to sell electricity generated with the use of facilities and equipment accounting for 15 percent of their working capacity. Since November 2003, the non-commercial partnership "Trade System Administrator of the Wholesale Electricity Market", in accordance with the rules for the wholesale electricity (power) market during the transition period, has been holding electricity bidding in the free trading sector. According to the laws underlying the electric utilities reform, subsequently free trading will be extended over the whole volume of trading.
- The Federal Grid Company – OAO Federal Grid Company of Unified Energy System ("FGC") – was established in June 2002, as a wholly-owned subsidiary of RAO UES, to manage the transmission of electricity through the use of transmission assets received or earmarked for receipt from RAO UES and its subsidiaries.
- The System Operator – OAO System Operator-Central Dispatch Unit of Unified Energy System ("SO-CDU") – was established in June 2002 to perform electricity dispatch functions within the unified electricity system of the Russian Federation through the use of assets received or earmarked for receipt from RAO UES and its subsidiaries.
- On 29 May 2003 the Board of Directors of RAO UES has approved a Concept of the Group's strategy for the period from 2003 through 2008. This document provides a detailed description of the major changes that are slated to take place in the Group during the electric utilities reform program.



## **RAO UES Group**

### **Notes to the Consolidated Financial Statements for the year ended 31 December 2003**

(in millions of Russian Roubles)

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#### **Note 1: The Group and its operations (continued)**

- At the end of December 2003, the Russian Federation Government issued Directive #1939-p, which set out the procedure for establishing 7 interregional trunk grid companies, to be incorporated by the Russian Federal Property Fund (ownership interest – 85%) and FGC (ownership interest – 15%).
- All the individual Energos that are subject to reform have developed their respective reform plans and submitted them to RAO UES. At present, these reform plans are being discussed, agreed and approved by the management bodies of RAO UES and the government bodies.
- On 23 April 2004, the Board of Directors of RAO UES approved the incorporation of 14 regional generating companies. It is planned that these companies will ultimately own power plants, currently owned by RAO UES subsidiaries.
- As at 5 July 2004, 30 subsidiaries of RAO UES had held General shareholders meeting at which plans for reorganization had been approved.

At this time, the impact of the industry changes on both the financial results and position of the Group cannot be readily assessed because the specific, detailed mechanisms to effect the restructuring are still being determined. Accordingly, no provision has been recognised for the effects of the restructuring process.

#### **Note 2: Financial condition**

At 31 December 2003, the Group's current liabilities exceeded its current assets by Russian Roubles ("RR") 812 million (31 December 2002: RR 12,815 million). The Group has improved its financial position, largely through better cash collections and forgiveness of tax penalties and interest.

The effects of the restructuring of accounts and taxes payable are described in Notes 17, 19 and 20. However, there still remains a significant amount of uncollected accounts receivable from earlier periods. Management has continued its collection and restructuring efforts to reduce the outstanding balances. There is legislation enabling the Group to cut off non-payers, but this is only possible to a certain extent due to strategic and political factors. Federal, municipal and other governmental organisations make up a significant proportion of the debtor balance as at 31 December 2003. The Group has provided against doubtful accounts receivable, as further described in Notes 9 and 11.

The Group is affected by government policy through control of tariffs and other factors. The RECs do not always permit tariff increases in line with increases in the Group's costs and thus some tariffs are insufficient to cover all the costs of generation and distribution. Moreover, these tariffs consider costs only on a Russian statutory basis and, accordingly, exclude additional costs recognised under an IFRS basis of accounting. As a result, tariffs do not consistently allow for an adequate return on investment and currently do not provide sufficient funds for the full replacement of property, plant and equipment. Furthermore, the Group also experiences difficulties raising finance for the necessary investment in generation, transmission and distribution assets.

Group management has been taking the following actions in order to address the issues noted above and improve the Group's financial position:

- introduction of improved financial budgeting procedures; a strong focus on timely cash collection of current and old debtor balances; restructuring of liabilities for repayment over a longer period;
- discussions with strategic investors, and identification and assessment of projects requiring investment funds;
- negotiations with federal and regional governments and regulators for real increases in tariffs to support adequate long term investment into the Group's generation, transmission and distribution assets; and
- active participation in the restructuring of the electricity sector (see Note 1).

Management believes that ultimately a stable regulatory regime and a competitive power market will be put in place such that the Group and its successors will be able to raise needed capital to sustain the business. However, there can be no assurance in this regard.

## RAO UES Group

### Notes to the Consolidated Financial Statements for the year ended 31 December 2003

(in millions of Russian Roubles)

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#### Note 3: Basis of presentation

These consolidated financial statements have been prepared in accordance with, and comply with, International Financial Reporting Standards, including International Accounting Standards and Interpretations issued by the IASB ("IFRS").

Each enterprise of the Group 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 ("RAR") with the exception of foreign companies which prepare their statutory financial statements in accordance with their statutory accounting requirements. The accompanying financial statements are based on the statutory records and adjusted and reclassified for the purpose of fair presentation in accordance with IFRS.

The preparation of consolidated financial statements in accordance with IFRS requires management to make prudent estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates have principally been made in respect of the impairment provision on property, plant and equipment, deferred profits taxes, allowance for doubtful debtors and fair values of financial instruments. Actual results could differ from these estimates.

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

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

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

The main guidelines followed in restating the corresponding figures were:

- All corresponding amounts were stated in terms of the measuring unit current at 31 December 2002;
- Monetary assets and liabilities held at 31 December 2002 were not restated because they were already expressed in terms of the monetary unit current at 31 December 2002;
- The appraisal values of property, plant and equipment and the impact of any impairment have been restated by applying relevant conversion factors beginning with the appraisal date together with adjustments for additions, disposals and depreciation, all restated by applying the relevant conversion factors;
- Non-monetary assets and liabilities (those balance sheet items that were not expressed in terms of the monetary unit current at 31 December 2002) and components of shareholders' equity were restated from their historical cost by applying the change in the general price index from the date the non-monetary item originated to 31 December 2002;

## RAO UES Group

### Notes to the Consolidated Financial Statements for the year ended 31 December 2003

(in millions of Russian Roubles)

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#### Note 3: Basis of presentation (continued)

- All items in the statement of operations and cash flows were restated by applying the change in the general price index from the dates when the items were initially transacted to 31 December 2002;
- Gains or losses that arose as a result of holding monetary assets and liabilities for the year ended 31 December 2002 were included in the statement of operations as a net monetary gain.

**Reclassifications.** Certain reclassifications have been made to prior year data to conform to the current year presentation.

#### Note 4: Summary of significant accounting policies

**Principles of consolidation.** The consolidated financial statements comprise the financial statements of RAO UES and the financial statements of those entities whose operations are controlled by RAO UES. Control is presumed to exist when RAO UES controls, directly or indirectly through subsidiaries, greater than 50 percent of voting rights. The Group consolidates a number of companies in which the Group owns less than 50 percent of the voting shares. Control exists for such entities on the basis of a dominant shareholding combined with other factors which allow the Group to exercise control.

A significant majority of the principal subsidiary Companies described in Note 5 were transferred to RAO UES by the state on and after its incorporation into a joint stock company. These transfers represented a reorganisation of assets under common control and, accordingly, are accounted for in a manner similar to uniting of interests from the date of privatisation of each Group entity.

All material inter-group balances and transactions have been eliminated. Separate disclosure is made of minority interests.

**Associated enterprises.** Investments in associated enterprises are accounted for using the equity method of accounting, based upon the percentage of ownership held by the Group. Associated enterprises are entities over which RAO UES is presumed to exercise significant influence but which it does not control.

**Investments.** Investments intended to be held for an indefinite period of time are classified as available-for-sale; these are included in other non-current assets unless management has the express intention of holding the investment for less than 12 months from the balance sheet date, they will need to be sold to raise operating capital or they mature within 12 months, in which case they are included in other current assets. Management determines the appropriate classification of its investments at the time of the purchase and re-evaluates such designation on a regular basis.

Available-for-sale investments principally comprise non-marketable securities, which are not publicly traded or listed on the Russian stock exchange. For these investments, fair value is estimated by reference to a variety of methods including those based on their earnings and those using the discounted value of estimated future cash flows. In assessing the fair value, management makes assumptions that are based on market conditions existing at each balance sheet date.

All purchases and sales of investments are recognised on the settlement date, which is the date that the investment is delivered to or by the Group. Cost of purchase includes transaction costs. The available-for-sale investments are subsequently carried at fair value. Unrealised gains and losses arising from changes in the fair value of these investments are included in the fair value reserve in shareholders' equity in the period in which they arise. Realised gains and losses from the disposal of available-for-sale investments are included in the statement of operations in the period in which they arise.

The Group does not hold any investments held-to-maturity or for trading purposes.

**Loans issued.** Loans issued are recognised initially at the fair value of the consideration given, net of transaction costs incurred. Fair value is determined with reference to market interest rates applicable to the borrowers when the loans were issued. Loans issued by the Group are measured at amortised cost. Amortised cost is the amount at which the loan was measured at initial recognition minus principal repayments plus the cumulative amortisation of any difference between that initial amount and the maturity amount, and minus any write down for impairment.

## RAO UES Group

### Notes to the Consolidated Financial Statements for the year ended 31 December 2003

(in millions of Russian Roubles)

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#### Note 4: Summary of significant accounting policies (continued)

**Foreign currency.** Monetary assets and liabilities, which are held by Group entities and denominated in foreign currencies at the balance sheet date, are translated into Russian Roubles at the exchange rates prevailing at that date. Foreign currency transactions are accounted for at the exchange rates prevailing at the date of the transaction. Gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in the statement of operations.

The balance sheets of foreign subsidiaries are translated into Russian Roubles at the exchange rate prevailing at the reporting date. Statements of operations of foreign entities are translated at average exchange rate for the year. Exchange differences arising on the translation of the net assets of foreign subsidiaries are recognised as translation differences and included in shareholders' equity.

The official rate of exchange, as determined by the Central Bank of the Russian Federation, between the Russian Rouble and the US Dollar ("US\$") at 31 December 2003 was RR 29.45: US\$ 1.00 (31 December 2002: RR 31.78: US\$ 1.00). Exchange restrictions and currency controls exist relating to converting the Russian Rouble into other currencies. The RR is not freely convertible in most countries outside the Russian Federation.

**Dividends.** Dividends are recognised as a liability and deducted from equity at the balance sheet date only if they are declared (approved by shareholders) before or on the balance sheet date. Dividends are disclosed when they are either proposed before the balance sheet date or proposed or declared after the balance sheet date, but before the financial statements are authorized for issue.

**Property, plant and equipment.** Property, plant and equipment are stated at depreciated replacement cost, based upon values determined by a third party valuation at 31 December 1997, and adjusted for subsequent additions at cost, disposals and depreciation, and restated for the impact of inflation until 31 December 2002. At each reporting date management assesses whether there is any indication of impairment of property, plant and equipment. If any such indication exists, management estimates the recoverable amount which is determined as the higher of an asset's net selling price and its value in use. The carrying amount is reduced to the recoverable amount and the difference is recognised as an expense (impairment loss) in the statement of operations. An impairment loss recognised in prior years is reversed if there has been a change in the estimates used to determine an asset's recoverable amount.

The amounts determined by the third party valuation represent an estimate of depreciated replacement cost. The third party valuation was performed in order to determine a basis for cost, because the historical accounting records for property, plant and equipment were not readily available. Therefore, this third party valuation is not a recurring feature since it was intended to determine the initial cost basis of property, plant and equipment. The change in carrying value arising from this valuation was recorded directly to retained earnings.

Major renewals and improvements are capitalised and the assets replaced are retired. Maintenance, repairs and minor renewals are expensed as incurred. Minor renewals include all expenditures that do not result in a technical enhancement of an asset beyond its original capability. Gains and losses arising from the retirement of property, plant and equipment are included in the statement of operations as incurred.

During the period of time that is required to complete and prepare the asset for its intended use interest costs on borrowings to finance the construction of property, plant and equipment are capitalised. All other borrowing costs are expensed.

Depreciation on property, plant and equipment is calculated on a straight-line basis over the estimated useful life of the asset when it is put into use. For the property, plant and equipment which was subject to the third party valuation as at 31 December 1997, the depreciation rate applied is based on the estimated remaining useful lives as at the valuation date. The useful lives, in years, of assets by type of facility are as follows:

## RAO UES Group

### Notes to the Consolidated Financial Statements for the year ended 31 December 2003

(in millions of Russian Roubles)

#### Note 4: Summary of significant accounting policies (continued)

Type of facility	Acquired prior to 31 December 1997	Acquired subsequent to 31 December 1997
Electricity and heat generation	3 - 80	20 - 80
Electricity transmission	14 - 40	25 - 40
Electricity distribution	3 - 40	25 - 40
Heating network	3 - 40	20 - 40
Other	8 - 24	10 - 40

Social assets are not capitalized as they are not expected to result in future economic benefits to the Group. Costs associated with fulfilling the Group's social responsibilities are expensed as incurred.

**Cash and cash equivalents.** Cash comprises cash in hand, cash deposited in banks. Cash equivalents comprise short-term high liquid investments that may be readily converted into cash and have a maturity of three months or less from the date of acquisition and are subject to insignificant changes in value.

The statement of cash flows has been prepared in accordance with IAS 7 "Cash Flow Statements". The Group relies to some extent on non-cash transactions. Investing activities and financing activities, as disclosed in the statement of cash flows, represent actual cash transactions. The total of operating activities also represents actual cash flow from operations. However, individual items within this part of the statement of cash flows are stated inclusive of both cash and non-cash transactions. Management believes that the benefits of providing individual cash items within operating activities is outweighed by the cost of preparation.

**Mutual settlements, barter and non-cash settlements.** A portion of sales and purchases is settled by mutual settlements, barter and non-cash settlements. These settlements are generally in the form of direct settlement by goods or services with the final customer, cancellation of mutual balances or through a chain of non-cash transactions involving several companies. Non-cash settlements which are expected to be settled within 12 months are recorded as other current assets. These include "veksels" or "bills of exchange" which are negotiable debt obligations. The receivables and payables recorded in the consolidated balance sheet, that are expected to be settled by mutual settlements, barter or non-cash settlements, reflect management's estimate of the fair value to be received or given up in non-cash settlements.

**Accounts receivable and prepayments.** Accounts receivable are recorded inclusive of value added taxes which are payable to tax authorities upon collection of such receivables. Trade and other receivables are adjusted for an allowance made for impairment of these receivables. Such an allowance for doubtful debtors is established if there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables. The amount of the allowance is the difference between the carrying amount and the recoverable amount, being the present value of expected cash flows, discounted at the market rate of interest for similar borrowers at the date of origination of the receivables.

**Value added tax on purchases and sales.** Value added taxes related to sales is payable to tax authorities upon collection of receivables from customers. Input VAT is reclaimable against sales VAT upon payment for purchases. The tax authorities permit the settlement of VAT on a net basis. VAT related to sales and purchases which have not been settled at the balance sheet date (VAT deferred) is recognised in the balance sheet on a gross basis and disclosed separately as a current asset and liability. Where provision has been made for impairment of receivables, impairment loss is recorded for the gross amount of the debtor's balance, including VAT. The related VAT deferred liability is maintained until the debtor is written off for tax purposes.

**Inventories.** Inventories are valued at the lower of net realisable value and weighted average cost. Provision is made for potential losses on obsolete or slow-moving inventories, taking into account their expected use and future realisable value.

## RAO UES Group

### Notes to the Consolidated Financial Statements for the year ended 31 December 2003

(in millions of Russian Roubles)

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#### Note 4: Summary of significant accounting policies (continued)

**Deferred profit taxes.** Deferred profit tax assets and liabilities are calculated in respect of temporary differences using the balance sheet liability method. Deferred profit tax is provided for all temporary differences arising between the tax basis of assets and liabilities and their carrying values for financial reporting purposes. A deferred profit tax asset is recorded only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised. Deferred profit tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates that have been enacted or substantively enacted at the balance sheet date.

Deferred profit tax is not provided for the undistributed earnings of subsidiaries, as the Group requires profits to be reinvested, and only insignificant dividends are declared. Deferred profit tax is provided for the undistributed earnings of associated enterprises.

**Accounts payable and accrued charges.** Accounts payable are stated inclusive of value added tax which is reclaimable from the tax authorities upon the later of receipt of goods and services or the payment of the associated payable.

If accounts payable are restructured and the fair value of the restructured payable differs by more than ten percent from the original liability, then the fair value of the restructured payable is measured as the present value of the future cash flows discounted at the interest rate available to the Group at the date of the restructuring. The amount of the discount is credited to the statement of operations (monetary effects and financing items) as a gain on restructuring, and the non-current portion of the discounted payable is reclassified to other non-current liabilities. The discount is amortised over the period of the restructuring as an interest expense.

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

**Minority interest.** Minority interest represents the minority shareholders' proportionate share of the equity of the Group's subsidiaries. This has been calculated based upon the minority interests' ownership percentage of these subsidiaries. Specific rights on dissolution for preference shareholders are included in the calculation of minority interests.

**Pension and post-employment benefits.** In the normal course of business the Group contributes to the Russian Federation state pension scheme on behalf of its employees. Mandatory contributions to the governmental pension scheme are expensed when incurred. Discretionary pensions and other post-employment benefits are included in wages, benefits and payroll taxes in the statement of operations, however, separate disclosures are not provided as these costs are not material.

**Environmental liabilities.** Liabilities for environmental remediation are recorded where there is a present obligation, the payment is probable and reliable estimates exist.

**Revenue recognition.** Revenue is recognised on the delivery of electricity and heat and on the dispatch of non-utility goods and services through the end of the period. Revenue amounts are presented exclusive of value added tax.

Revenue is based on the application of authorised tariffs for electricity and heat sales as approved by the regional RECs.

**Earnings per share.** Preference shares are considered to be participating shares, as their dividend may not be less than that given with respect to ordinary shares. An earnings per share is determined by dividing the net income attributable to ordinary and preference shareholders by the weighted average number of ordinary and preference shares outstanding during the reporting period, **excluding the average number of treasury shares held by the Group**. Preference shares participate in losses.

## **RAO UES Group**

### **Notes to the Consolidated Financial Statements for the year ended 31 December 2003**

(in millions of Russian Roubles)

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#### **Note 4: Summary of significant accounting policies (continued)**

**Treasury shares.** Treasury shares are stated at weighted average cost. Any gains or losses arising on the disposal of treasury shares are recorded directly in shareholders' equity.

**Seasonality.** Demand for electricity and heat is influenced by both the season of the year and the relative severity of the weather. Revenues from heating are concentrated within the months of October to March. A similar, though less severe, concentration of electricity sales occurs within the same period. The seasonality of electricity and heat production has a corresponding impact on the usage of fuel and the purchase of power.

Furthermore, during the periods of lower production from April to September, there is an increase in the expenditures on repairs and maintenance. This seasonality does not impact the revenue or cost recognition policies of the Group.

## RAO UES Group

### Notes to the Consolidated Financial Statements for the year ended 31 December 2003

(in millions of Russian Roubles)

#### Note 5: Principal subsidiaries

The following are the significant subsidiary enterprises which have been consolidated into the Group's financial statements. All subsidiaries with the exception of foreign companies are incorporated and operate in Russia.

#### *Regional generation and distribution companies*

Name	Ownership %	Voting %	Name	Ownership %	Voting %
<b>Centre</b>			<b>South</b>		
Astrakhanenergo	49.0	49.0	Dagenergo	51.3	51.3
Belgorodenergo	49.0	65.3	Experimentalnaya TETS	74.9	100.0
Bryanskenergo	49.0	49.0	Kabbalkenergo	65.3	65.3
Ivenergo	49.7	56.6	Kalmenergo	96.4	96.4
Kalugaenergo	52.3	52.3	Karachaevo-Cherkesskenergo	100.0	100.0
Kostromaenergo	49.0	49.0	Kubanenergo	49.0	49.0
Kurskenergo	49.4	59.8	Rostovenergo	48.4	62.8
Lipetskenergo	49.0	49.0	Sevkavkazenergo	49.0	49.0
Mosenergo	50.9	50.9	Stavropolenergo	55.1	71.9
Orelenergo	49.5	49.2			
Ryazanenergo	49.0	49.0	<b>Ural</b>		
Smolenskenergo	48.7	59.3	Chelyabenergo	49.0	58.1
Tambovenergo	49.0	56.0	Kirovenergo	48.2	64.0
Tulenergo	49.0	49.0	Kurganenergo	49.0	49.0
Tverenergo	49.0	65.3	Orenburgenergo	100.0	100.0
Vladimirenergo	49.0	49.0	Permenergo	49.0	64.4
Volgogradenergo	49.0	61.3	Sverdlovenergo	49.0	65.3
Vologdaenergo	49.0	49.0	Tumenenergo	100.0	100.0
Voronezhenergo	49.0	65.3	Udmurtenergo	49.0	55.4
Yarenergo	47.8	60.3			
<b>North-West</b>			<b>Siberia</b>		
Arkhenergo	49.0	59.1	Altaienergo	54.7	72.2
Karelenegergo	100.0	100.0	Buryatenergo	47.0	47.0
Kolenergo	49.2	65.5	Chitaenergo	49.0	62.2
Komienergo	50.1	50.3	Khakasenergo	100.0	100.0
Lenenergo	49.0	57.4	Krasnoyarskenergo	51.8	51.8
Novgorodenergo	49.0	62.9	Kuzbassenergo	49.0	49.0
Pskovenergo	49.0	49.0	Omskenergo	49.0	49.0
Yantarenergo	100.0	100.0	Tomskenergo	52.0	59.9
<b>Middle Volga</b>			<b>East</b>		
Chuvashenergo	100.0	100.0	Amurenergo	53.1	53.1
Marienergo	64.4	70.1	Dalenergo	49.0	65.3
Mordovenergo	53.1	53.1	Geotherm	72.6	78.5
Nizhnovenergo	49.0	62.3	Khabarovskenergo	48.5	48.5
Penzaenergo	49.0	60.2	Kolymaenergo	93.0	93.0
Samaraenergo	49.0	56.3	Kamchatskenergo	49.0	49.0
Saratovenergo	49.0	49.0	Magadanenergo	49.0	49.0
Ulyanovskenergo	49.0	65.3	Sakhalinenergo	49.0	49.0
			Sakhaenergo	49.0	100.0
			Yakutskenergo	49.6	58.7



## RAO UES Group

### Notes to the Consolidated Financial Statements for the year ended 31 December 2003

(in millions of Russian Roubles)

#### Note 5: Principal subsidiaries (continued)

##### *Hydrogenerating companies*

Name	Ownership %	Voting %	Name	Ownership %	Voting %
Bureyskaya GES	75.4	76.5	Volzhskaya GES (Volzhsk)	83.3	83.3
Kabbalk GES	81.4	98.0	Volzhskaya GES (Zhigulevsk)	85.0	85.8
Kamskaya GES	100.0	100.0	Votkinskaya GES	59.8	74.2
Kaskad Verhnevolzhskih GES	100.0	100.0	Zaramagskie GES	90.3	92.0
Sayano-Shushenskaya GES	78.9	78.9	Zeiskaya GES	56.9	57.4
Sulakenergo	99.3	99.3	Zelenchugskie GES	100.0	100.0
Taimyrenego	100.0	100.0			

##### *Thermal generating companies*

Name	Ownership %	Voting %	Name	Ownership %	Voting %
Berezovskaya GRES –1	100.0	100.0	Nevinomysskaya GRES	100.0	100.0
Cherepetskaya GRES	55.8	55.8	North-West Station	68.2	75.3
Gusinoozerskaya GRES	100.0	100.0	Novocherkasskaya GRES	100.0	100.0
Kaliningradskaya TETS –2	81.8	81.8	Pechorskaya GRES	51.0	51.0
Kharanorskaya GRES	100.0	100.0	Permskaya GRES	100.0	100.0
Kirishskaya GRES	100.0	100.0	Pskovskaya GRES	50.0	50.0
Konakovskaya GRES	51.0	51.0	Ryazanskaya GRES	100.0	100.0
Kostromskaya GRES	51.0	51.0	Shekinskie PGU	92.1	98.9
Krasnoyarskaya GRES –2	100.0	100.0	Stavropolskaya GRES	51.0	51.0
Kuban GRES	79.8	99.9	Troitskaya GRES	100.0	100.0
Lutek	56.3	56.3			

##### *Construction companies*

Name	Ownership %	Voting %	Name	Ownership %	Voting %
Boguchanskaya GES	64.2	64.2	Chirkeigesstroi	100.0	100.0
Bureyagesstroy	100.0	100.0			

##### *Other*

Name	Ownership %	Voting %	Name	Ownership %	Voting %
Central Dispatch Centre	100.0	100.0	System Operator	100.0	100.0
Federal Grid Company	100.0	100.0	Media-Holding REN-TV	70.0	70.0
Insurance company LIDER	100.0	100.0	Inter RAO UES	60.0	60.0
Centre of Settlement			Energy Centre	75.0	75.0
Optimisation	100.0	100.0			

##### *Foreign companies*

Name	Ownership %	Voting %	Country
RAO Nordic	60.0	100.0	Finland
Telasi	45.0	75.0	Georgia
Mtkvari	60.0	100.0	Georgia
Transenergy	30.0	50.0	Georgia
Silk Road	60.0	100.0	Netherlands
Gardabani	60.0	100.0	Netherlands
Georgia	60.0	100.0	Netherlands
MEK	54.0	100.0	Armenia

## RAO UES Group

### Notes to the Consolidated Financial Statements for the year ended 31 December 2003

(in millions of Russian Roubles)

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#### Note 5: Principal subsidiaries (continued)

The Group controls Centre for Assistance in Restructuring the Electricity Sector, a non-commercial partnership.

Differences between ownership interest and voting interest normally represent the effect of preference shares. Primarily RAO UES does not hold any preference shares of its subsidiaries. Such preference shares do not have any voting rights, unless dividends have not been declared fully at the Annual shareholders' meeting.

In August 2001, the Group acquired a controlling interest in OOO Media-Holding REN-TV, an entity which holds television broadcasting equipment and licenses. This investment was acquired and held exclusively with a view to its subsequent disposal in the near future. In absence of completion of the disposal it has been consolidated with the effect from October 2002.

In June 2003, RAO Nordic, a Group entity, founded ZAO MEK, an entity located in Armenia. RAO Nordic owns a 90 percent interest in this entity. In September 2003, ZAO MEK purchased assets of ZAO Sevan-Razdansky Kaskad, a cascade of hydroplants located in Armenia, for a fair value consideration of RR 1,172 million (US\$ 25 million payable immediately and EUR 17 million payable along with related interest over a period of 32 years commencing in 2009). The Group has settled the US\$ 25 million payment to the seller by assuming the liability of ZAO Armyanskaya AS, a nuclear power plant, located in Armenia ("Armenian NPP"), owned by the government of Armenia, which is also the ultimate owner of the assets purchased, to a supplier of nuclear fuel. The assumed liability is payable in equal installments over a period of 5 years commencing in 2004.

The assets arising from the acquisition are as follows:

Accounts receivable and prepayments	43
Other current assets	52
Property, plant and equipment	1,077
<b>Fair value of assets acquired</b>	<b>1,172</b>

The above acquisition was accounted for under the purchase method of accounting. The purchase price of the foreign acquisition was translated at the exchange rate in effect at the date of acquisition.

In May 2003, RAO Nordic, a Group entity, concluded an agreement to settle a separate liability of Armenian NPP to another supplier of nuclear fuel for the amount of RR 490 million (US\$ 15.7 million). RAO Nordic will receive this amount back from Armenian NPP along with interest during two years commencing in June 2003. As of 31 December 2003 the outstanding recoverable balance of RR 181 million is included within other current assets.

Inter RAO UES and the government of Armenia have entered into a contract in the respect of the Armenian NPP and will be entitled to the higher of 25 percent of that plant's annual net income during the period of 5 years commencing in September 2003 or US\$ 0.1 million annually as a management fee (in the case of annual dividend distribution).

In August 2003, the Group acquired 100 percent of the shares of AES Silk Road, AES Gardabani and AES Georgia, all holding companies based in the Netherlands, from the AES Group. In addition, amounts receivable by the AES Group from the above companies amounting to RR 15,923 million (US\$ 522 million) were acquired by the Group. The total consideration paid in cash was RR 704 million (US\$ 23 million).

The above holding companies were, in their turn, the owners of shares in certain entities located in Georgia: 75 percent of AES Telasi, an entity which holds electricity distribution assets, 100 percent of OOO AES Mtkvari, an entity which holds electricity and heat generation assets; 50 percent of AES Transenergy, an entity which exports energy; AES Georgia was also the owner of the management rights of Khramesy 1 and 2 hydrogeneration plants.

## RAO UES Group

### Notes to the Consolidated Financial Statements for the year ended 31 December 2003

(in millions of Russian Roubles)

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#### Note 5: Principal subsidiaries (continued)

The assets and liabilities arising from the acquisition are as follows:

Cash and cash equivalents	53
Accounts receivable and prepayments	1,247
Other current assets	448
Property, plant and equipment	613
Other non-current assets	258
Accounts payable and accrued charges	(221)
Other current liabilities	(343)
Non-current debt	(97)
Other non-current liabilities	(153)
Minority interest	(1,101)
<b>Fair value of net assets acquired</b>	<b>704</b>
Less: cash and cash equivalents in subsidiary acquired	(53)
<b>Cash flow on acquisition, net of cash acquired</b>	<b>651</b>

The acquisition was accounted for under the purchase method of accounting. The results of operations of the acquired businesses were included in the consolidated financial statements as of the respective date of acquisition. The purchase price of the foreign acquisition was translated at the exchange rates in effect as the respective date of acquisition.

During the year ended 31 December 2003 there were certain other changes in RAO UES' ownership percentage of several of its subsidiaries, which had an immaterial impact on the statement of operations.

#### Note 6: Segment information

**Primary reporting segments - business segments.** The Group is organised into four main business segments:

- **"Transmission segment"** this segment principally comprises RAO UES, FGC, SO-CDU and CDC, which maintain and operate the high voltage electricity transmission grid and perform electricity dispatch functions. Transmission fees are set by the FEC;
- **"Energos segment"** consists of regional electricity and heat generation and distribution. The majority of electricity generated by energos is sold within the regions in which the energo operates at tariffs set by RECs. Certain energos have surplus generation and sell electricity via FOREM. Tariffs in FOREM are set by the FEC;
- **"Hydro and thermal generating stations segment"** consists of entities that produce and sell electricity to energos through FOREM, at tariffs set by the FEC; and
- **"Unallocated"** consists of numerous insignificant segments including construction, and export generation and sales.

## RAO UES Group

### Notes to the Consolidated Financial Statements for the year ended 31 December 2003

(in millions of Russian Roubles)

#### Note 6: Segment information (continued)

Year ended 31 December 2003				Hydro and thermal generating stations	Unallocated	Consolidation adjustments	Total
	Transmission	Energos					
Gross revenues	59,201	561,918		63,095	34,353	-	718,567
Intra-group revenues	(54,978)	(9,900)		(49,133)	(11,407)	-	(125,418)
Net revenues	4,223	552,018		13,962	22,946	-	593,149
Segment income	28,504	26,962		2,537	6,474	-	64,477
Capital expenditures	10,599	45,480		14,125	6,769	-	76,973
Depreciation and amortisation	7,958	45,545		6,434	1,834	-	61,771
Doubtful debtors expense / (release)	289	(3,413)		654	934	-	(1,536)
Year ended 31 December 2002				Hydro and thermal generating stations	Unallocated	Consolidation adjustments	Total
Gross revenues	44,977	489,875		43,654	24,346	-	602,852
Intra-group revenues	(43,190)	(10,364)		(37,441)	(8,448)	-	(99,443)
Net revenues	1,787	479,511		6,213	15,898	-	503,409
Segment income / (loss)	29,206	(1,469)		(8,418)	(77)	(942)	18,300
Capital expenditures	6,397	34,682		8,122	3,208	-	52,409
Depreciation and amortisation	7,675	43,484		6,130	1,882	-	59,171
Doubtful debtors expense / (release)	398	10,092		2,242	(619)	-	12,113
As at 31 December 2003				Hydro and thermal generating stations	Unallocated	Consolidation adjustments	Total
Segment total assets	148,721	739,889		140,723	112,530	(54,518)	1,087,345
Associates	-	-		-	196	-	196
Total assets	148,721	739,889		140,723	112,726	(54,518)	1,087,541
Segment liabilities	4,353	144,554		33,033	136,790	(38,180)	280,550
Total liabilities	4,353	144,554		33,033	136,790	(38,180)	280,550
As at 31 December 2002				Hydro and thermal generating stations	Unallocated	Consolidation adjustments	Total
Segment total assets	148,723	728,760		123,582	111,761	(51,390)	1,061,436
Associates	-	-		-	-	-	-
Total assets	148,723	728,760		123,582	111,761	(51,390)	1,061,436
Segment liabilities	3,157	141,351		30,517	126,357	(30,342)	271,040
Total liabilities	3,157	141,351		30,517	126,357	(30,342)	271,040

## RAO UES Group

### Notes to the Consolidated Financial Statements for the year ended 31 December 2003

(in millions of Russian Roubles)

#### Note 6: Segment information (continued)

**Secondary reporting segments - geographical segments.** The Group operates in seven geographical areas within the Russian Federation. These geographical areas correspond to the regions established for system operation. Group entities have been aggregated within these geographical areas based on the area where their assets are located, with the exception of the Transmission segment. The transmission grid, owned by RAO UES and FGC, is located throughout the territory of the Russian Federation, but is recorded in the books of these enterprises without details of geographic location. Accordingly, it is not practicable to split these assets on a geographical basis. The Group's assets generate revenues primarily within the geographical region where they are located.

	Revenue		Total assets		Capital expenditures	
	Year ended 31 December 2003	Year ended 31 December 2002	31 December 2003	31 December 2002	Year ended 31 December 2003	Year ended 31 December 2002
Transmission segment	58,588	44,977	148,721	148,723	10,599	6,397
Centre	180,713	152,880	252,458	250,076	15,294	11,365
North-West	67,267	56,223	82,194	71,477	6,514	4,224
Urals	138,763	121,649	187,967	189,214	10,291	6,929
Siberia	74,765	64,961	127,791	121,418	8,167	6,399
Middle Volga	63,540	51,028	63,875	66,101	2,697	2,240
East	60,426	53,446	107,162	99,553	11,450	8,344
South	45,444	37,665	65,558	65,214	6,329	4,351
	689,506	582,829	1,035,726	1,011,776	71,341	50,249
Unallocated	29,061	20,023	106,333	101,050	5,632	2,160
Consolidation adjustments	(125,418)	(99,443)	(54,518)	(51,390)	-	-
Total	593,149	503,409	1,087,541	1,061,436	76,973	52,409

#### Note 7: Related parties

**Associates.** In late 2002 management re-assessed the level of influence that the Group had over Bashkirenergo and Novosibirskenergo previously regarded as associates and determined that this no longer amounted to significant influence. Consequently, the investments in these companies, which had formerly been accounted for as associates were re-classified as non-current available-for-sale investments.

In May 2003, the Group acquired 25 percent of the share capital of a new entity JSC "Rossiskiye kommunalniye sistemy" (RKS). RKS is incorporated and operates in Russia. The entity was set up with the purpose to provide local utility services to customers.

The following transactions were carried out with associates, Bashkirenergo, Novosibirskenergo and RKS, the majority of which are based on tariffs set by the FEC:

	Year ended 31 December 2003	Year ended 31 December 2002
Transmission fee income	-	733
Electricity revenues	106	226
Heating revenues	263	-
Rental fee income	-	39
Purchased power expense	-	135
Electricity and heat distribution expense	15	-

## RAO UES Group

### Notes to the Consolidated Financial Statements for the year ended 31 December 2003

(in millions of Russian Roubles)

#### Note 7: Related parties (continued)

**Directors' compensation.** Compensation is paid to members of the Management Board of RAO UES for their services in full time management positions. The compensation is made up of a contractual salary, non-cash benefits, and a performance bonus depending on results for the year according to Russian statutory financial statements. The compensation is approved by the Board of Directors. Discretionary bonuses are also payable to members of the Management Board, which are approved by the Chairman of the Managing Board according to his perception of the value of their contribution.

Fees, compensation or allowances to the members of the Board of Directors for their services in that capacity and for attending Board meetings are paid depending on results for the year. Under the Russian legislation, fees, compensation or allowances to the members of the Board of Directors, being government employees, are transferred to the federal budget.

Salary, bonuses and other payments paid to members of the Board of Directors and of the Management Board by the Group, included in wages, benefits and payroll taxes in the statement of operations, amounted to RR 172.7 million for the year ended 31 December 2003. Salary, bonuses and other payments paid to members of the Management Board by the Group, included in wages, benefits and payroll taxes in the statement of operations, amounted to RR 90 million for the year ended 31 December 2002.

#### Note 8: Property, plant and equipment

##### Appraised value or cost

	Electricity and heat generation	Electricity transmission	Electricity distribution	Heating networks	Construction in progress	Other	Total
Opening balance as at 31 December 2002	708,271	227,193	700,560	126,488	222,442	230,157	2,215,111
Additions	1,622	738	718	794	68,651	4,450	76,973
Additions through acquisition of subsidiaries	1,150	523	-	-	-	17	1,690
Transfers	43,154	3,337	13,549	4,170	(77,206)	12,996	-
Disposals	(4,716)	(28)	(3,636)	(313)	(8,297)	(5,893)	(22,883)
Closing balance as at 31 December 2003	749,481	231,763	711,191	131,139	205,590	241,727	2,270,891

##### Accumulated depreciation (including impairment)

Opening balance as at 31 December 2002	(439,678)	(123,770)	(492,939)	(89,478)	(43,631)	(161,927)	(1,351,423)
Charge for the period	(15,938)	(7,958)	(16,894)	(4,541)	-	(16,440)	(61,771)
Transfers	(10,140)	(242)	(2,119)	(1,324)	15,575	(1,750)	-
Disposals	3,158	72	3,488	307	2,461	4,996	14,482
Closing balance as at 31 December 2003	(462,598)	(131,898)	(508,464)	(95,036)	(25,595)	(175,121)	(1,398,712)
Net book value as at 31 December 2003	286,883	99,865	202,727	36,103	179,995	66,606	872,179
Net book value as at 31 December 2002	268,593	103,423	207,621	37,010	178,811	68,230	863,688

Construction in progress represents the carrying amount of property, plant and equipment that has not yet been put into operation, including generating stations under construction.

## RAO UES Group

### Notes to the Consolidated Financial Statements for the year ended 31 December 2003

(in millions of Russian Roubles)

#### Note 8: Property, plant and equipment (continued)

Depreciation is charged once an asset is available for service.

Other property, plant and equipment includes motor vehicles, computer equipment, office fixtures and other equipment.

The assets transferred to the Group upon privatisation did not include the land on which the Group's buildings and facilities are situated. The Group has the option to purchase this land upon application to the state registrar body or to continue occupying this land under a rental agreement. Russian legislation does not specify an expiry date to this option. As at 31 December 2003, the majority of the Group's companies have not filed any application to exercise the purchase option.

A portion of property, plant and equipment additions has been settled through mutual settlement, barter and other non-cash means. Non-cash transactions in respect of property, plant and equipment are:

	Year ended 31 December 2003	Year ended 31 December 2002
Non-cash acquisitions	12,630	11,579
Non-cash proceeds from the sale of property, plant and equipment	2,553	998

The majority of the non-cash acquisitions related to construction in progress.

**Impairment.** For the year ended 31 December 2003, management has assessed the adequacy of its existing impairment provision and concluded that the amount is appropriate. Accordingly, no further adjustment has been recorded.

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 for the impairment provision. In management's opinion, the existing provision represents the best estimate of the impact of impairment as a result of the current economic conditions in the Russian Federation.

Included in the impairment provision is RR 16,256 million related to items recorded as construction in progress, which currently are not planned to be completed and are therefore fully impaired.

#### Note 9. Other non-current assets

	31 December 2003	31 December 2002
Available-for-sale investments	9,551	12,409
Advances to contractors	10,830	8,551
Restructured trade receivables (Net of allowance for doubtful debtors of RR 5,051 million as at 31 December 2003 and RR 8,976 million as at 31 December 2002)	2,936	3,633
Other	2,883	749
	26,200	25,342

At 31 December 2003, the above other balance included RR 193 million of receivables due from Armenia NPP as described in Note 5.

## RAO UES Group

### Notes to the Consolidated Financial Statements for the year ended 31 December 2003

(in millions of Russian Roubles)

#### Note 10: Cash and cash equivalents

	31 December 2003	31 December 2002
Cash at bank and in hand	19,982	14,457
Cash equivalents	9,856	2,802
Foreign currency accounts	2,140	310
	31,978	17,569

Cash equivalents comprise short term investments in bank promissory notes and certificates of deposit.

#### Note 11: Accounts receivable and prepayments

	31 December 2003	31 December 2002
Trade receivables (Net of allowance for doubtful debtors of RR 40,527 million as at 31 December 2003 and RR 47,509 million as at 31 December 2002)	43,590	37,984
Value added tax recoverable	24,445	20,392
Advances to suppliers and prepayments	14,577	13,337
Receivables from associates	151	-
Other receivables (Net of allowance for doubtful debtors of RR 6,534 million as at 31 December 2003 and RR 5,569 million as at 31 December 2002)	22,577	21,258
	105,340	92,971

At 31 December 2003 and 31 December 2002, the above other receivables balance included RR 7,135 million and RR 5,212 million of tax prepayments, respectively, which are to be settled against future tax liabilities.

Management has determined the allowance for doubtful debtors based on specific customer identification, customer payment trends, subsequent receipts and settlements and analyses of expected future cash flows. Based on the expected collection rate, discount rates of 16–25 percent have been used in the estimate of fair value of future cash flows. The effects of discounting are reflected in the doubtful debtor allowance and expense. The management of the Group believes that Group entities will be able to realise the net receivable amount through direct collections and other non-cash settlements.

Certain trade receivables have been restructured and as a result are due to be realised more than one year from the balance sheet date (see Note 9). The loss on restructuring is included in doubtful debtors expense.

For the year ended 31 December 2003: approximately 13 percent (the year ended 31 December 2002: 22 percent) of the Group's accounts receivables were settled via non-cash settlements.



## RAO UES Group

### Notes to the Consolidated Financial Statements for the year ended 31 December 2003

(in millions of Russian Roubles)

#### Note 12: Inventories

	31 December 2003	31 December 2002
Materials and supplies	24,443	24,980
Fuel production stocks	16,858	12,077
Other inventories	1,430	1,326
	42,731	38,383

The above inventory balances are recorded net of an obsolescence provision of RR 2,036 million and RR 2,281 million as at 31 December 2003 and 31 December 2002, respectively.

At 31 December 2003 and 31 December 2002, the inventory balance included RR 18,200 million and RR 11,238 million, respectively, of inventory pledged as collateral under loan agreements.

#### Note 13: Shareholders' equity

##### Share Capital

	Number of shares issued and fully paid	31 December 2003	31 December 2002
Ordinary shares	41,041,753,984	147,439	147,439
Preference shares	2,075,149,384	7,667	7,667
		155,106	155,106

The authorised number of ordinary and preference shares are 47,509,289,488 and 2,075,149,384 respectively, both with a nominal value per share of 0.5 Russian Roubles.

**Ordinary shares and preference shares.** Preference shares have no right of conversion or redemption, but are entitled to a minimum annual dividend of 10 percent of net statutory profit. In total the preference dividend may not be less than the ordinary dividend and is not cumulative. Preference shares carry no voting rights except when dividends on preference shares have not been declared fully at the Annual Shareholders' meeting. In liquidation preference shareholders are first paid any declared unpaid dividends and then the nominal value of the shares ("liquidation value"). Following this, preference shareholders participate equally in the distribution of remaining assets with ordinary shareholders.

On 7 May 1998 the law number 74-FZ "On the Peculiarities of Share Distribution of UES" was signed by the President of the Russian Federation. This law stipulates that a minimum of 51 percent of voting shares in RAO UES be held by the government of the Russian Federation and that foreign investors are limited to owning not more than 25 percent of the voting shares of the company. The practical implications of this foreign ownership limitation for RAO UES or its shareholders are unclear.

**Dividends.** The annual statutory accounts of the parent company, RAO UES, are the basis for the annual profit distribution and other appropriations. The specific Russian legislation identifies the basis of distribution as the net profit for the year. For 2003, the statutory profit for the parent company, RAO UES, as reported in the published statutory reporting forms, was RR 24,605 million. However this legislation and other statutory laws and regulations dealing with the distribution rights are open to legal interpretation and, accordingly, management believes at present it would not be appropriate to disclose an amount for the distributable reserves in these financial statements.

A dividend was declared in 2004 in respect of the year ended 31 December 2003 of RR 0.0469 per ordinary share (in 2003 in respect of 2002: RR 0.0337 per ordinary share) and RR 0.2283 per preference share (in 2003 in respect of 2002: RR 0.2916 per preference share).

## RAO UES Group

### Notes to the Consolidated Financial Statements for the year ended 31 December 2003

(in millions of Russian Roubles)

#### Note 13: Shareholders' equity (continued)

**Fair value reserve.** The fair value reserve, relating to the changes in the fair value of available-for-sale investments, at 31 December 2003 was a debit of RR 9,122 million (31 December 2002: a debit of RR 4,225 million), and is included in retained earnings and fair value reserve.

**Treasury shares.** The Group periodically purchases and sells treasury shares. Treasury shares as at 31 December 2003 represent 49,138,221 (31 December 2002: 400,938,211) ordinary shares and 16,768,863 (31 December 2002: 17,701,098) preference shares.

	Cost as at 31 December 2002	Purchases and disposals, net	Cost as at 31 December 2003
Ordinary shares	709	(409)	300
Preference shares	61	(6)	55
	770	(415)	355

#### Note 14: Minority interest

	Year ended 31 December 2003	Year ended 31 December 2002
Opening balance, beginning of year	223,981	220,302
Change in fair value of available-for-sale investments	26	(791)
Share of net result	(2,701)	3,853
Acquisitions and changes in Group structure	205	2,015
Dividends	(1,824)	(1,398)
Closing balance, end of period	219,687	223,981

#### Note 15: Profit tax

##### Profit tax expense

	Year ended 31 December 2003	Year ended 31 December 2002
Current profit tax charge	(16,621)	(20,816)
Deferred profit tax (charge) / benefit	(8,133)	44,951
Share of associate profit tax benefit	-	148
<b>Total profit tax (charge) / benefit</b>	<b>(24,754)</b>	<b>24,283</b>

During the year ended 31 December 2003 most members of the Group were subject to profit tax rates of 24 percent on taxable profit.

In the context of Russian tax legislation, tax losses in different Group companies may not be relieved against taxable profit of other Group companies. Accordingly profit tax may accrue even where there is a net consolidated tax loss.

## RAO UES Group

### Notes to the Consolidated Financial Statements for the year ended 31 December 2003

(in millions of Russian Roubles)

#### Note 15: Profit tax (continued)

Net income before profit tax for financial reporting purposes is reconciled to profit tax expenses as follows:

	Year ended 31 December 2003	Year ended 31 December 2002
<b>Income before profit tax</b>	49,036	14,564
Theoretical profit charge at an average statutory tax rate of 24 percent	(11,769)	(3,495)
Tax effect of items which are not deductible or assessable for taxation purposes:		
Tax interest and penalties	1,318	(1,002)
Non-temporary elements of monetary gains	-	(26,626)
Other non-deductible and non-taxable items, net	(5,229)	(5,149)
Inflation effect on deferred tax balance at beginning of the period	-	11,878
Effect of change in tax base of accounts receivable (see Note 20)	-	11,917
Effect of statutory revaluation on tax base	(7,856)	38,047
Non-recognised deferred tax assets movements	1,275	2,359
Losses carried forward	1,239	-
Other	(3,732)	(3,646)
<b>Total profit tax (charge) / benefit</b>	<b>(24,754)</b>	<b>24,283</b>

The non-temporary elements of monetary gain reflected the effect of the theoretical tax charge on inflation with respect to non-monetary items of a non-temporary nature (e.g. shareholders' equity, minority interests and deferred profit tax liabilities). As described in Note 3, effective from 1 January 2003 Group no longer applies the provision of IAS 29.

As described in Note 1, RAO UES established a wholly-owned subsidiary, FGC, to hold and manage the high voltage transmission assets. In December 2002 RAO UES established Kharanorskaya GRES and Kirishskaya GRES, two wholly owned subsidiaries to perform electricity generation as separate legal entities. The value of the property, plant and equipment transferred to FGC, Kharanorskaya GRES and Kirishskaya GRES by RAO UES was determined by a third party valuer. This valuation is used for Russian statutory and tax accounting purposes. Consequently, included within the effect of statutory revaluation for the period to 31 December 2003 is a deferred tax benefit of RR 3,479 million in respect of the revaluation of assets transferred to FGC, Kharanorskaya GRES and Kirishskaya GRES prior to that date (the year ended 31 December 2002: RR 13,973 million).

**Deferred profit tax.** Differences between IFRS and Russian statutory taxation regulations give rise to certain temporary differences between the carrying value of certain assets and liabilities for financial reporting purposes and for profit tax purposes. Deferred profit tax assets and liabilities are measured at 24 percent, the rate applicable when the assets or liabilities will reverse.

#### Deferred profit tax liabilities

	31 December 2003	Movement for the period effected		31 December 2002
		Statement of operations	Shareholders' equity	
Trade receivables	(8,439)	1,495	-	(9,934)
Property, plant and equipment	65,292	4,839	-	60,453
Accounts payable	4,052	(370)	-	4,422
Inventories	(340)	(184)	-	(156)
Losses carried forward	(917)	(917)	-	-
Other	(1,753)	(1,971)	395	(177)
	57,895	2,892	395	54,608

**RAO UES Group****Notes to the Consolidated Financial Statements for the year ended 31 December 2003**

(in millions of Russian Roubles)

**Note 15: Profit tax (continued)***Deferred profit tax assets*

	31 December 2003	Movement for the period effected statement of operations	31 December 2002
Trade receivables	2,447	(2,249)	4,696
Property, plant and equipment	9,989	(5,782)	15,771
Accounts payable	(872)	902	(1,774)
Inventories	99	58	41
Losses carried forward	322	322	-
Other	669	233	436
Deferred profit tax assets	12,654	(6,516)	19,170
Less: non-recognised deferred tax assets	(8,773)	1,275	(10,048)
	3,881	(5,241)	9,122

Revisions to the Russian tax legislation were approved in 2002 which provide clarification of the tax law enacted as at 1 January 2002. In accordance with these revisions, statutory revaluations on property, plant and equipment of up to 30 percent of the statutory carrying value as at 1 January 2001 are deductible for profit tax purposes through depreciation. Previous revisions of the profit tax legislation did not provide clear guidance regarding the deductibility of these revaluations. Consequently, the Group had not recognised the impact resulting from these statutory revaluations until these clarifications were provided in 2002. The effect of the statutory revaluation was an increase of the tax base of property, plant and equipment, which decreased the temporary differences between their carrying value for financial and tax purposes.

As at 31 December 2003 the Group has not recognized a deferred tax liability in respect of RR 55,872 million (31 December 2002: RR 49,310 million) temporary differences associated with investments in subsidiaries as the Group is able to control the timing of the reversal of these temporary differences and does not intend to reverse them in foreseeable future.

## RAO UES Group

### Notes to the Consolidated Financial Statements for the year ended 31 December 2003

(in millions of Russian Roubles)

#### Note 16: Non-current debt

	Currency	Effective interest rate	Due	31 December 2003	31 December 2002
Central and regional government loans	US\$	LIBOR + 3.0%	2003 and thereafter	2,816	2,633
Central and regional government loans	RR	21.0% - 48.0%	2003 and thereafter	554	927
Bonds issued by subsidiaries	RR / US\$ *	8.0%	2003-2004	259	4,202
Bonds issued by subsidiaries	RR	18.0%	2005-2006	1,000	-
Bonds – RAO UES	RR	15.0%	2005	3,000	3,000
Bonds – RAO UES	RR / US\$ *	5.0%	2003	-	2,231
Bank debt from foreign banks	Euro	EURIBOR + 4.1%	2003-2005	1,723	2,470
Bank debt from foreign banks	US\$	LIBOR + 4.0%	2003-2009	1,714	2,225
Bank debt from foreign banks	US\$	LIBOR + 3.5%	2003 and thereafter	993	1,251
Bank debt from Russian banks	RR**	14.0% - 23.0%	2003 and thereafter	2,460	10,214
Bank debt from Russian banks	Euro	8.0% - 10.0%	2003	-	58
Other long-term debt				2,354	1,385
Total non-current debt				16,873	30,596
Less: current portion of non-current debt				(4,317)	(17,135)
				12,556	13,461

\* For both interest payments and the redemption of these bonds, the Russian Rouble amount is adjusted to reflect any currency movements between the Russian Rouble and the US\$ from the date of issuance of the bonds.

\*\* In December 2001 the Group received a RR 27,629 million loan from Sberbank, which was repayable in equal quarterly instalments through 2004. The loan interest varied depending on the turnover on the RAO UES accounts in Sberbank and was equal to 19% as at 31 December 2002. RAO UES repaid the loan ahead of schedule in March 2003.

#### Maturity table

	31 December 2003	31 December 2002
<b>Due for repayment</b>		
Between one and two years	6,164	5,749
Between two and five years	4,353	6,164
After five years	2,039	1,548
	12,556	13,461

Except as otherwise noted, the majority of the above bank debt is obtained at fixed interest rates.

The effective interest rate is the market interest rate applicable to the loan at the date of origination for fixed rate loans and the current market rate for floating rate loans.

The Group has not entered into any hedging arrangements in respect of its foreign currency obligations or interest rate exposures.

At the balance sheet date, the estimated fair value of total non-current debt (including the current portion) was RR 17,258 million (31 December 2002: RR 30,804 million), which is estimated by discounting the future contractual cash flows at the estimated current market interest rates available to the Group for similar financial instruments.

## RAO UES Group

### Notes to the Consolidated Financial Statements for the year ended 31 December 2003

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#### Note 17: Other non-current liabilities

	31 December 2003	31 December 2002
Taxes payable	21,276	29,077
Trade payables	1,588	5,007
Other	6,386	3,191
Total other non-current liabilities	29,250	37,275
Less: current portion of restructured liabilities	(5,048)	(10,403)
	24,202	26,872

In accordance with Government Resolution No. 1002 dated 3 September 1999, most members of the Group have restructured taxes including fines and interest to be repaid over a period of up to 10 years. Non-adherence to certain payment schedules could result in the gross amount of taxes payable including fines and interest becoming due on demand. Additionally, a number of Group entities have restructured trade payables to be repaid over a period of up to five years. Based on the contractual dates of repayment, discount rates of 21 - 25 percent have been used in the estimate of the fair value of these liabilities.

The discounting of the restructured payable amounts gives rise to a gain, as disclosed in Note 22.

The maturity profile is as follows:

	31 December 2003	31 December 2002
Between one and two years	4,572	7,335
Between two and five years	9,457	10,313
After five years	10,173	9,224
	24,202	26,872

#### Note 18: Current debt and current portion of non-current debt

	Effective interest rate	31 December 2003	31 December 2002
Current debt	10.0% - 26.0%	46,179	25,101
Current portion of non-current debt		4,317	17,135
		50,496	42,236

#### Note 19: Accounts payable and accrued charges

	31 December 2003	31 December 2002
Trade payables	51,683	50,133
Accrued liabilities and other creditors	34,625	28,312
Bills of exchange payable	2,040	1,182
Dividends payable	466	398
Payables to associates	16	-
Current portion of trade payables and other creditors restructured to long-term	928	4,312
	89,758	84,337

## RAO UES Group

### Notes to the Consolidated Financial Statements for the year ended 31 December 2003

(in millions of Russian Roubles)

#### Note 19: Accounts payable and accrued charges (continued)

For the year ended 31 December 2003, approximately 18 percent (the year ended 31 December 2002: 17 percent) of the Group's accounts payable and accrued charges were settled via non-cash settlements.

Restructured trade payables which are payable more than one year from the balance sheet date are reflected within other non-current liabilities as described in Note 17. The effect of restructuring the trade payables is included in Note 22.

Accrued liabilities and other creditors as at 31 December 2003 includes an accrual of RR 1,079 million for compensation to employees whose services are to be terminated during the course of the restructuring process (31 December 2002: RR 1,690 million). The plans, including the amount of such compensation, number of employees and the approximate timing whereby such payments will be made, have been approved by the Boards of Directors of the affected Group entities. The corresponding expense is included in wages, benefits and payroll taxes in the statement of operations.

#### Note 20: Taxes payable

	31 December 2003	31 December 2002
Value added tax	21,568	21,717
Fines and interest	8,429	8,205
Profit tax	4,395	4,396
Property tax	2,110	2,308
Employee taxes	2,234	2,602
Turnover taxes	217	2,029
Other taxes	2,570	2,178
Current portion of taxes restructured to long-term	4,120	6,091
	45,643	49,526

Included in the payable for value added tax is RR 16,649 million which only become payable to the authorities when the underlying receivables balance is either recovered or written off (31 December 2002: RR 17,325 million).

Prior to 2002, the Group did not intend to write off certain doubtful debtors for tax reporting purposes and as a result the Group did not record a deferred profit tax assets in respect of such debtors as it was not probable that this asset would be realised. In addition, as VAT is payable when cash is collected or receivables are written off for tax reporting purposes, the VAT related to these doubtful debtors was not deemed payable and was therefore not recognized as a liability. During 2002, these positions were reconsidered by management and doubtful debts are now being written off for tax reporting purposes. Consequently, an additional deferred tax asset and an additional liability for VAT of RR 11,917 million and RR 9,911 million, respectively, have been recognised in the balance sheet as at 31 December 2002. The additional VAT was recognised as an expense within the doubtful debtors expense, and the additional deferred tax recognised as a deferred profit tax benefit (see Note 15), in the consolidated statement of operations for the year ended 31 December 2002.

The principal tax liabilities past due, excluding the amounts which have been restructured, accrue interest each day at one three hundredth of the current refinance rate of the Central Bank of the Russian Federation. As at 31 December 2003 the refinance rate was 16 percent (31 December 2002: 21 percent). Interest does not accrue on tax fines and interest.

Restructured taxes, including fines and interest, which are payable more than one year from the balance sheet date are reflected within other non-current liabilities as described in Note 17. The gain on restructuring the taxes payable is included in Note 22.

For the year ended 31 December 2003, approximately 1 percent (the year ended 31 December 2002: 1 percent) of the Group's taxes payable were settled via non-cash settlements.

## RAO UES Group

### Notes to the Consolidated Financial Statements for the year ended 31 December 2003

(in millions of Russian Roubles)

#### Note 21: Governmental assistance

During the year ended 31 December 2003 the Federal government of the Russian Federation and regional governments gave financial assistance equal to RR 4,063 million (the year ended 31 December 2002: RR 3,940 million) for certain entities in the Far East region and RR 1,137 million (the year ended 31 December 2002: RR 1,430 million) for other Group entities. The assistance in respect of these periods has been recorded as revenue in the statement of operations.

#### Note 22: Monetary effects and financing items

	Year ended 31 December 2003	Year ended 31 December 2002
Gain on restructured accounts payable and taxes payable	1,714	6,089
Monetary gain	-	9,017
Imputed interest income	188	1,192
Interest expense	(18,849)	(18,599)
Foreign exchange gain / (loss)	1,560	(1,672)
	(15,387)	(3,973)

The discounting of restructured payable amounts gives rise to gain. Subsequent to its initial recognition, the discount is amortized over the period of the restructuring as an expense; RR 11,112 million of such amortisation was included in interest expense for the year ended 31 December 2003 (the year ended 31 December 2002: RR 8,537 million). Further information on the restructuring of accounts payable and taxes payable is contained in Notes 17, 19 and 20.

Imputed interest income is recorded as a result of the amortisation of the discount recognised in December 2001 on loans issued at that date to major suppliers of Group at below market interest rates.

#### Note 23: Earnings per share

	Year ended 31 December 2003	Year ended 31 December 2002
Weighted average number of ordinary shares outstanding (thousands)	41,041,754	41,041,754
Weighted average number of preference shares outstanding (thousands)	2,075,149	2,075,149
Adjusted for weighted average number of treasury shares (thousands)	(154,142)	(418,267)
Weighted average number of ordinary and preference shares outstanding (thousands)	42,962,761	42,698,636
Net income	26,983	34,994
<b>Earnings per ordinary and preference share – basic and diluted (in Russian Roubles)</b>	<b>0.63</b>	<b>0.82</b>



## RAO UES Group

### Notes to the Consolidated Financial Statements for the year ended 31 December 2003

(in millions of Russian Roubles)

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#### Note 24: Commitments

**Sales commitments.** The Group entered into two export contracts with Fortum Power and Heat Oy ("Fortum"), a shareholder of Lenenergo, and one contract with Pohjolan Voima Oy. One contract with Fortum is for the supply of a minimum of 1.6 million MWh of electricity per year, at prices between Euro 12.15 and Euro 20.50 per MWh. This contract expires at the end of 2007. The second contract with Fortum is for the supply of between 0.35 million and 0.50 million MWh of electricity per year at Euro 17.25 per MWh, through to the end of 2008.

The contract with Pohjolan Voima Oy is for the supply of a minimum of 2.7 million MWh of electricity per year, at prices between Euro 16.20 and Euro 16.70 per MWh. This contract expires at the end of 2004.

**Purchase commitment.** In May 2002 the Group concluded a framework agreement with its electricity supplier, Lietovus Energiya, for the period 2002-2004. The quantity of electricity to be supplied is 6.2 mln MWh and 5.4 mln MWh for the years 2003 and 2004 respectively. The average price for the period 1 May 2002 to 1 May 2004 is fixed. The average price for the period 1 May 2004 to 31 December 2004 will be defined by an additional agreement. The Group's total purchase commitments for the three months being ended 31 December 2003 amount to US\$ 20 million or RR 599 million and for 2004 year amount to Euro 65 million or RR 2,294 million.

In August 2003 the Group concluded an agreement with its electricity supplier, Ekibastuzskaya GRES-2, for the period 2003-2007. The quantity of electricity to be supplied is 6.0 mln MWh per annum. The price for the to period 14 August 2003 to 14 August 2004 is fixed. The average price for the period 14 August 2004 to 31 December 2007 will be defined by an additional agreement annually, but the average price will not vary for more than 10% from the latest price. The Group's total purchase commitments for the period 2003-2007 amount to RR 6,528 million.

**Fuel commitments.** Group entities have numerous fuel contracts. These fuel contracts represent less than the total annual fuel requirement of the Group. Additional fuel requirements are purchased through short-term agreements and on a spot basis from a variety of suppliers. Prices under the Group's natural gas and coal contracts are generally determined by reference to base amounts adjusted to reflect provisions for changes in regulatory prices, published inflation indices and current market prices.

**Social commitments.** Group entities contribute to the maintenance and upkeep of the local infrastructure and the welfare of its employees, including contributions toward the development and maintenance of housing, hospitals, transport services, recreation and other social needs in the geographical areas in which it operates.

**Capital commitments.** Future capital expenditures for which contracts have been signed amount to RR 43,517 million at 31 December 2003 and RR 44,014 million at 31 December 2002.

#### Note 25: Contingencies

**Political environment.** The operations and earnings of Group entities continue, from time to time and in varying degrees, to be affected by political, legislative, fiscal and regulatory developments, including those related to environmental protection, in Russia.

**Insurance.** The Group holds limited insurance policies in relation to its assets, operations, public liability or other insurable risks. Accordingly, the Group is exposed for those risks for which it does not have insurance.

**Legal proceedings.** Group entities are 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.

## RAO UES Group

### Notes to the Consolidated Financial Statements for the year ended 31 December 2003

(in millions of Russian Roubles)

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#### Note 25: Contingencies (continued)

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

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

**Environmental matters.** Group entities and their predecessor entities 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. 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, other than any amounts which have been accrued in the accompanying consolidated balance sheet.

#### Note 26: Financial instruments and financial risk factors

**Financial risk factors.** The Group's activities expose it to a variety of financial risks, including the effects of: changes in foreign currency exchange rates, changes in interest rates and the collectibility of receivables. The Group does not have a risk policy in order to hedge its financial exposures.

**Credit risk.** Financial assets which potentially subject Group entities to concentrations of credit risk consist principally of trade receivables. Although collection of receivables could be influenced by economic factors, management believes that there is no significant risk of loss to the Group beyond the allowance for doubtful debtors already recorded.

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

**Foreign exchange risk.** The Group primarily operates within the Russian Federation, with minimal exports of electricity. The majority of the Group's purchases are denominated in Russian Roubles. The major concentration of foreign exchange risk is in relation to foreign currency denominated sales and purchase commitments, as disclosed in Note 24, and foreign currency denominated debt and Russian Rouble denominated debt linked to US\$ currency movements, as disclosed in Note 16.

**Interest rate risk.** The Group's income and operating cash flows are substantially independent of changes in market interest rates. The Group is exposed to interest rate risk through market value fluctuations of interest-bearing long-term borrowings. The majority of interest rates on long term borrowings are fixed, these are disclosed in Note 16. The Group has no significant interest-bearing assets.

#### Note 27. Subsequent events

In December 2003 Sverdlovenergo registered a prospectus with the Federal Commission for Securities Markets for the issuance of 0.5 million bonds with a nominal value of RR 1,000 per bond. In March 2004 the bonds were placed on the open market. The bonds yield an effective interest of 11.5 percent and mature in March 2007. Interest is payable semi-annually.

In March 2004 Lenenergo registered a prospectus with the Federal Commission for Securities Markets for the issuance of 3 million bonds with a nominal value of RR 1,000 per bond. In April 2004 the bonds were placed on the open market. The bonds yield an effective interest of 10.25 percent and mature in April 2007. Interest is payable semi-annually.