Joint Stock Company
Territorial Generating Company №1

International Financial Reporting Standards
Consolidated Financial Statements and
Independent Auditor's Report

31 December 2007

Contents

PRICEWATERHOUSECOOPERS

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Independent Auditor's Report

To the Shareholders and Board of Directors of Joint-Stock Company Territorial Generating Company №1

We have audited the accompanying consolidated financial statements of Joint-Stock Company (JSC) Territorial Generating Company №1 and its subsidiary (the 'Group') which comprise the consolidated balance sheet as at 31 December 2007 and the consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory notes.

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

Auditor's Responsibility
Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

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

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

Opinion
In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2007, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

ZAO PricewaterhouseCoopers Audit

27 June 2008
St. Petersburg, Russia

C TERRITORIAL GENERATING COMPANY №1
)NSOLIDATED BALANCE SHEET AS AT 31 DECEMBER 2007
thousands of Russian Roubles, except per share amounts)

	Notes	31 December 2007	31 December 2006
SSETS			
)n-current assets			
operty, plant and equipment	6	44 973 328	29 569 592
ıng-term investments	7	240 553	1 295 030
eferred tax assets	8	200 962	215 917
her non-current assets	9	1 464 919	110 713
)tal non-current assets		**46 879 762**	**31 191 252**
ırrent assets			
ash and cash equivalents	10	15 976 549	659 218
'ailable-for-sale investments	11	4 105 356	-
counts receivable and prepayments	12	5 693 623	4 345 229
ventories	13	2 375 246	2 212 031
)tal current assets		**28 150 774**	**7 216 478**
)TAL ASSETS		**75 030 536**	**38 407 730**
)UITY AND LIABILITIES			
ıuity			
ıare capital	14	38 509 598	29 022 225
easury shares	14	(6 740)	(10 000)
ıare premium	14	23 271 781	-
erger reserve	14	(6 086 949)	(5 769 751)
ir value reserve		(93 560)	42 780
etained earnings		3 530 184	1 505 975
ıuity attributable to the shareholders of TGC-1		**59 124 314**	**24 791 229**
nority interest		35 318	103 426
)TAL EQUITY		**59 159 632**	**24 894 655**
)n-current liabilities			
eferred tax liabilities	8	2 603 708	1 578 126
ng-term borrowings	15	1 343 349	1 736 340
st-employment benefits obligations	16	604 021	505 608
ıtal non-current liabilities		**4 551 078**	**3 820 074**
ırrent liabilities			
ıort-term borrowings and current portion of long-term ıorrowings	17	4 935 610	5 210 226
counts payable and accrued liabilities	18	6 134 241	4 190 886
her taxes payable	19	249 975	291 889
ıtal current liabilities		**11 319 826**	**9 693 001**
)TAL LIABILITIES		**15 870 904**	**13 513 075**
)TAL EQUITY AND LIABILITIES		**75 030 536**	**38 407 730**

ıproved on behalf of the Board of Directors on 27 June 2008.

eneral Director Rodin V.N.

ıief Accountant Stanishevskaya R.V.

CONSOLIDATED INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2007

(in thousands of Russian Roubles, except per share amounts)

	Notes	Year ended 31 December 2007	Year ended 31 December 2006
Revenue			
Sales of electricity		14 249 974	11 256 197
Sales of heat		13 070 330	11 143 662
Other sales		925 896	798 356
Total revenue		**28 246 200**	**23 198 215**
Operating expenses, net	20	(28 204 965)	(23 068 956)
Impairment loss reversed during the year	3, 6	3 824 248	8 025 359
Impairment loss recognised during the year	3, 6	(55 501)	(5 993 876)
Total operating costs		**(24 436 218)**	**(21 037 473)**
Operating profit		**3 809 982**	**2 160 742**
Foreign exchange loss, net		(64 426)	(12 347)
Finance cost, net	22	(250 079)	(408 505)
Profit before income tax		**3 495 477**	**1 739 890**
Income tax charge	8	(1 098 298)	(593 509)
Profit for the year		**2 397 179**	**1 146 381**
Attributable to:			
Shareholders of TGC-1		2 409 513	1 292 752
Minority interest		(12 334)	(146 371)
Earnings per share for profit attributable to the shareholders of TGC-1, basic and diluted (in Russian Roubles)	23	0.0008	0.0027

JSC TERRITORIAL GENERATING COMPANY №1
CONSOLIDATED CASH FLOW STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2007
(in thousands of Russian Roubles, except per share amounts)

	Notes	Year ended 31 December 2007	Year ended 31 December 2006
Cash flows from operating activities			
Profit before income tax		3 495 477	1 739 890
Adjustments to reconcile profit before tax and net cash from operating activities:			
Depreciation of property, plant and equipment	6	2 044 821	1 423 943
Impairment loss reversed during the year	6	(3 824 248)	(8 025 359)
Impairment loss recognised during the year	6	55 501	5 993 876
Change in provision for impairment of accounts receivable	20	(28 767)	13 908
Change in financial assets at fair value through profit or loss	20	94 267	(475 067)
Finance cost, net	22	250 079	408 505
Unrealised foreign exchange loss on non-operating items		56 397	12 348
Loss/(gain) on disposal of subsidiaries	21	44 940	(288 268)
Change in provision for impairment of inventories	13	(2 034)	24 510
Loss on disposal of property, plant end equipment		98 434	28 408
Increase of post-employment benefits obligations		98 413	44 175
Other non-cash items		3 830	22 973
Operating cash flows before working capital changes		**2 387 110**	**923 842**
(Increase)/decrease in accounts receivable and prepayments		(2 822 308)	824 234
Increase in inventories		(167 079)	(691 579)
Increase in accounts payable and accruals		1 989 174	1 048 545
Increase/(decrease) in taxes payable other than income tax		181 602	(27 436)
Cash generated from operations		**1 568 499**	**2 077 606**
Income tax paid		(223 516)	(655 453)
Interest paid		(457 140)	(364 647)
Net cash from operating activities		**887 843**	**1 057 506**
Cash flows from investing activities			
Purchase of property, plant and equipment		(13 854 592)	(3 389 429)
Proceeds from disposals of property, plant and equipment		67 080	55 086
Proceeds from disposals of subsidiaries		61 000	456 132
Proceeds from disposals of long-term investments	7	795 965	-
Purchase of long-term investments	7	(20 000)	-
Investments in bank deposits	11	(4 105 356)	-
Interest received		324 793	-
Capitalised interest paid		(96 190)	(95 899)
Net cash used in investing activities		**(16 827 300)**	**(2 974 110)**
Cash flows from financing activities			
Purchase of treasury shares	14	(20 558)	-
Proceeds from borrowings		8 787 100	10 596 435
Repayments of borrowings		(13 517 625)	(8 081 575)
Proceeds from issuance of bonds		4 000 000	-
Proceeds from share issue	14	32 400 000	-
Proceeds from sale of treasury shares	14	10 000	-
Dividends paid		(402 129)	(310 498)
Net cash from financing activities		**31 256 788**	**2 204 362**
Net increase in cash and cash equivalents		**15 317 331**	**287 758**
Cash and cash equivalents at the beginning of the year		**659 218**	**371 460**
Cash and cash equivalents at the end of the year	10	**15 976 549**	**659 218**

JSC TERRITORIAL GENERATING COMPANY №1
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2007
(in thousands of Russian Roubles, except per share amounts)

	Equity attributable to the shareholders of TGC-1								
	Share capital	**Treasury shares**	**Share premium**	**Merger reserve**	**Fair value reserve**	**Retained earnings**	**Total**	**Minority interest**	**Total equity**
Balance at 1 January 2006	**10 000**	**-**	**-**	**14 581 741**	**22 768**	**363 205**	**14 977 714**	**8 995 600**	**23 973 314**
Fair value gain on available-for-sale investments	-	-	-	-	26 332	-	**26 332**	20 690	**47 022**
Deferred tax on fair value gain	-	-	-	-	(6 320)	-	**(6 320)**	(4 966)	**(11 286)**
Net income recognised directly in equity	-	-	-	-	20 012	-	**20 012**	15 724	**35 736**
Profit for the year	-	-	-	-	-	1 292 752	**1 292 752**	(146 371)	**1 146 381**
Total recognised income for the year	-	-	-	-	20 012	1 292 752	**1 312 764**	(130 647)	**1 182 117**
Purchase of treasury shares (Note 14)	-	(10 000)	-	-	-	-	**(10 000)**	-	**(10 000)**
Dividends (Note 14)	-	-	-	-	-	(149 982)	**(149 982)**	(100 794)	**(250 776)**
Issuance of shares (Note 14)	29 012 225	-	-	(20 351 492)	-	-	**8 660 733**	(8 660 733)	**-**
Balance at 31 December 2006	**29 022 225**	**(10 000)**	**-**	**(5 769 751)**	**42 780**	**1 505 975**	**24 791 229**	**103 426**	**24 894 655**
Fair value loss on available-for-sale investments (Note 7)	-	-	-	-	(179 395)	-	**(179 395)**	-	**(179 395)**
Deferred tax on fair value loss	-	-	-	-	43 055	-	**43 055**	-	**43 055**
Net loss recognised directly in equity	-	-	-	-	(136 340)	-	**(136 340)**	-	**(136 340)**
Profit for the year	-	-	-	-	-	2 409 513	**2 409 513**	(12 334)	**2 397 179**
Total recognised income for the year	-	-	-	-	(136 340)	2 409 513	**2 409 513**	(12 334)	**2 397 179**
Purchase of treasury shares (Note 14)	-	(6 740)	(13 818)	-	-	-	**(20 558)**	-	**(20 558)**
Sale of treasury shares (Note 14)		10 000	-	-	-	-	**10 000**	-	**10 000**
Dividends	-	-	-	-	-	(385 304)	**(385 304)**	-	**(385 304)**
Issuance of shares	9 257 143	-	23 142 857	-	-	-	**32 400 000**	-	**32 400 000**
Issuance of shares for the purpose of acquisition of Murmanskaya TPP (Notes 1,14)	230 230	-	142 742	(317 198)	-	-	**55 774**	(55 774)	**-**
Balance at 31 December 2007	**38 509 598**	**(6 740)**	**23 271 781**	**(6 086 949)**	**(93 560)**	**3 530 184**	**59 124 314**	**35 318**	**59 159 632**

Note 1. General Information

1.1 The Company and its operations

Joint-Stock Company (JSC) Territorial Generating Company № 1 (hereinafter “TGC-1”, or the “Company”) was established on 25 March 2005 within the framework of the Russian electricity sector restructuring in accordance with Resolution No. 181 adopted by the Board of directors of RAO UES of Russia (hereinafter “RAO UES”) on 26 November 2004. The structure and principles of foundation of TGC-1 were adopted by the Board of Directors of RAO UES on 23 April 2004 (Resolution No. 168).

The Company was founded by three regional energy companies, all controlled by RAO UES: OJSC Lenenergo, OJSC Kolenergo and OJSC Karelenergogeneratsya. Since its foundation, TGC-1 is ultimately controlled by the Government of the Russian Federation (see also Note 1.3).

On 1 November 2006, OJSC Petersburg Generating Company, OJSC Kolskaya Generating Company, OJSC Apatitskaya Thermal Power Plant and OJSC Karelenergogeneratsya, all controlled by RAO UES, were merged into TGC-1 and ceased to exist as separate legal entities. Since that time TGC-1 has been the owner of their generating assets.

In May 2007, the Company issued additional ordinary shares in order to exchange them for the shares of OJSC Murmanskaya Thermal Power Plant (hereinafter “Murmanskaya TPP”) held by RAO UES and certain minority shareholders. After completion of the share exchange, the Company owns 84.06% of Murmanskaya TPP. The Company together with Murmanskaya TPP hereinafter is referred to as the Group.

As described in Note 14, in October 2007 the Company further increased its equity via additional issue of ordinary shares by closed subscription in favour of LLC Russian Energy Projects, an entity controlled by OJSC Gazprom, which is in turn controlled by the Government of the Russian Federation, and Fortum Heat and Power Oy (Finland). The shareholding structure of the Company after this share issue is described in Note 1.3.

On 26 October 2007, the Extraordinary General Meeting of Shareholders of RAO UES took a decision to spin off the Company from RAO UES according to the following scheme:

- OJSC “TGC-1 Holding” to be formed by way of spin-off from RAO UES as a new and a separate company, which holds as assets ordinary shares of TGC-1 previously owned by RAO UES;
- simultaneously (the same day) with its formation, OJSC “TGC-1 Holding” to be merged with and into TGC-1, which is the surviving entity. All of the assets of OJSC “TGC-1 Holding”, consisting of only the ordinary shares of TGC-1, will be transferred to TGC-1;
- upon the merger, OJSC “TGC-1 Holding” will cease to exist and its shares will be converted to shares of TGC-1;
- each holder of RAO UES shares, except the Russian Government:
    - on the day of formation of OJSC “TGC-1 Holding” – is entitled to a number of shares in OJSC “TGC-1 Holding” proportionally to the number of RAO UES shares held by such holder as at this day;
    - upon the conversion of OJSC “TGC-1 Holding” shares – becomes a shareholder of TGC-1.

The share of the Russian Government will be acquired by the entity related to OJSC Gazprom.

On 29 October 2007 the Extraordinary General Meeting of Shareholders of TGC-1 approved additional issue of shares for the purpose of merger of OJSC “TGC-1 Holding” into the Company in accordance with the following converting ratio:

- 0.0261552883800093 ordinary share of OJSC “TGC-1 Holding” will be converted into one ordinary share of the Company with par value of RUB 0.01 each;
- 0.0285600440926069 preference share of OJSC “TGC-1 Holding” will be converted into one preference share of the Company with par value of RUB 0.01 each.

Note 1. General Information (Continued)

Currently, the Group operates 55 power plants and its principal activity is electricity and heat generation.

The Group's generating assets are located in the North-West of Russia, in particular, St. Petersburg, the Leningrad region, the Murmansk region and Karelia. The Company's registered office is located at 1, Marsovo pole, 191186, Saint-Petersburg, Russia.

1.2 Operating environment

Whilst there have been improvements in economic trends in the Russian Federation, the country 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 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.

1.3 Relations with the State and current regulation

As at 31 December 2007, the Russian government owned over 50% of voting shares in RAO UES and over 50% of voting shares (including direct and indirect ownership) in OJSC Gazprom. In its turn, RAO UES owned 42.31% (31 December 2006: 55.6%) of voting shares of the Company, and LLC Russian Energy Projects, owned 17.67% (31 December 2006: nil) of voting shares of the Company. Therefore, the Russian government is the ultimate controlling party of the Group. Other significant shareholders as at 31 December 2007 were Fortum Power and Heat Oy (25.7%) and HC Interros (5.6%).

Until the share issue in October 2007 (see Note 1.1), RAO UES had direct control over the Group.

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 Service on Tariffs ("FST"), with respect to its wholesale energy purchases, and by the St. Petersburg and Leningrad Oblast Regional Services on Tariffs ("RSTs"), with respect to its retail electricity and heat sales. The operations of all generating facilities are coordinated by OAO System Operator – the Central Despatch Unit of Unified Energy System ("SO-CDU"). SO-CDU is controlled by RAO UES.

Tariffs which the Group may charge for sales of electricity and heat are governed by regulations specific to the electricity and heat industry and by regulations applicable to natural monopolies. Historically, such tariffs have been based on a "cost-plus" system, meaning cost of service plus a margin, where costs are determined under the Regulations on Accounting and Reporting of the Russian Federation, a basis of accounting which significantly differs from International Financial Reporting Standards.

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

1.4 Regulatory issues and sector restructuring

The Russian electric utilities industry is presently undergoing a restructuring process designed to introduce competition into the electricity sector and to create an environment in which RAO UES Group and its successor companies (including TGC-1) can raise capital required to maintain and expand current capacity.

A crucial step in developing a competitive wholesale electricity (capacity) market was the adoption of the new Wholesale Electric Power (Capacity) Market (NOREM) Rules of the Transitional Period approved by Resolution of the Government of the Russian Federation No. 529 dated 31 August 2006 and which came into force on 1 September 2006. Under the new wholesale market framework, electricity and power purchase-and-sale transactions in the regulated market sector are to be governed by a regulated bilateral contract system. From 1 September 2006, regulated contracts covered all volumes of electricity and power produced and consumed.

Note 1. General Information (Continued)

From 2007, the volumes of electricity (power) traded in the wholesale market at regulated prices began to be reduced. The pace of reduction was set by the Russian Federation Government according to socio-economic development forecasts. In 2007 up to 90% of the forecasted produced electricity volumes and 100% of capacity were traded at regulated prices. The period from 2006 to approximately 2011 is a transition period. After that, it is expected that a fully competitive wholesale market will be formed.

It is expected that in 2008 a Resolution of the Russian Government will be issued on the launch of the capacity market where available capacity volumes will be allowed to be traded at transition auctions providing for supplies during 2009-2011 and long-term auctions for 10 years supplies, given they pass through the competitive selection procedure in their respective free power flow zone. For the first time, the wholesale market agents will have the possibility to conclude non-regulated contracts for capacity supply.

1.5 Recent volatility in global financial markets

Since the second half of 2007 there has been a sharp rise in foreclosures in the US subprime mortgage market. The effects have spread beyond the US housing market as global investors have re-evaluated their exposure to risks, resulting in increased volatility and lower liquidity in the fixed income, equity, and derivative markets. The volume of wholesale financing has significantly reduced since August 2007. Such circumstances may affect the ability of the Group to obtain new borrowings and refinance its existing borrowings at terms and conditions that applied to similar transactions in recent periods. Debtors of the Group may also be affected by the lower liquidity situation which could in turn impact their ability to repay their amounts owed. Management is unable to reliably estimate the effects on the Group's financial position of any further possible deterioration in the liquidity of the financial markets and their increased volatility.

Note 2. Summary of Significant Accounting Policies

2.1 Basis of preparation

Statement of compliance

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) under the historical cost convention except as described below. The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated.

The Group 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). These consolidated financial statements are based on the statutory records and adjusted and reclassified for the purpose of fair presentation in accordance with IFRS.

Predecessor Accounting

In November 2006, RAO UES transferred to the Company the outstanding ordinary shares of OJSC Apatitskaya Thermal Power Plant (49.27%), OJSC Karelenergogeneratsya (100%), OJSC Kolskaya Generating Company (49.27%) and OJSC Petersburg Generating Company (56.01%). In its IFRS consolidated financial statements, the Company accounted for this business combination amongst entities under common control using the pooling of interests method. Accordingly, assets and liabilities of the transferred entities were initially accounted for at the carrying values as determined by RAO UES in its IFRS consolidated financial statements.

(in thousands of Russian Roubles, except per share amounts)

Note 2. Summary of Significant Accounting Policies (Continued)

As described in Note 1, in May 2007 the Company completed acquisition of 84.06% of shares in Murmanskaya TPP, an entity under control of RAO UES. The Company accounted for this transaction as for a business combination amongst entities under common control using the pooling of interest method. Therefore, comparative information for the year ended 31 December 2006 in these consolidated financial statements has been presented as if Murmanskaya TPP had been a subsidiary of the Company since 1 January 2006, with RAO UES's shareholding of 65.51%. The effect of the merger of Murmanskaya TPP on the opening balance is as follows:

	As previously reported as at and for the year ended 31 December 2006	Effect of the merger of Murmanskaya TPP	Restated as at and for the year ended 31 December 2006
Balance sheet:			
Assets			
Property, plant and equipment	28 976 074	593 518	29 569 592
Long-term investments	1 295 030	-	1 295 030
Deferred tax assets	-	215 917	215 917
Other non-current assets	105 911	4 802	110 713
Cash and cash equivalents	650 120	9 098	659 218
Accounts receivable and prepayments	3 827 650	517 579	4 345 229
Inventories	1 981 982	230 049	2 212 031
Total assets	**36 836 767**	**1 570 963**	**38 407 730**
Equity and Liabilities			
Share capital	(29 022 225)	-	(29 022 225)
Treasury shares	10 000	-	10 000
Merger reserve	6 266 345	(496 594)	5 769 751
Fair value reserve	(42 780)	-	(42 780)
Retained earnings	(1 806 127)	300 152	(1 505 975)
Minority interest	-	(103 426)	(103 426)
Total equity	**(24 594 787)**	**(299 868)**	**(24 894 655)**
Deferred tax liabilities	(1 578 126)	-	(1 578 126)
Long-term borrowings	(1 736 340)	-	(1 736 340)
Post-employment benefits	(501 361)	(4 247)	(505 608)
Short-term borrowings and current portion of long-term borrowings	(4 660 227)	(549 999)	(5 210 226)
Accounts payable and accrued liabilities	(3 487 034)	(703 852)	(4 190 886)
Other taxes payable	(278 892)	(12 997)	(291 889)
Total equity and liabilities	**(36 836 767)**	**(1 570 963)**	**(38 407 730)**
Income Statement:			
Revenue	21 593 702	1 604 513	23 198 215
Operating expenses	(20 876 119)	(2 192 837)	(23 068 956)
Impairment loss reversed during the year	7 947 024	78 335	8 025 359
Impairment loss recognised during the year	(5 993 876)	-	(5 993 876)
Foreign exchange loss, net	(12 347)	-	(12 347)
Finance cost	(382 695)	(25 810)	(408 505)
Income tax charge	(718 931)	125 422	(593 509)
Profit for the year	**1 556 758**	**(410 377)**	**1 146 381**

(in thousands of Russian Roubles, except per share amounts)

Note 2. Summary of Significant Accounting Policies (Continued)

Changes in presentation of Property, plant and equipment

Management amended allocation of impairment provision between the groups (types of facility) of Property, plant and equipment recorded as at 31 December 2006. The effect of the changes in impairment allocation on the opening balance of net book values of Property, plant and equipment by type of facility is as follows:

Net book values:	As previously reported as at 31 December 2006	Effect of the reclassification	Restated as at 31 December 2006
Production buildings	6 366 814	1 278 378	7 645 192
Hydrotechnical buildings	8 120 545	2 806 596	10 927 141
Generating equipment	4 266 234	(663 102)	3 603 132
Heating networks	1 906 390	(1 196 359)	710 031
Construction in progress	3 196 342	-	3 196 342
Other	5 119 749	(2 225 513)	2 894 236
Total	**28 976 074**	**-**	**28 976 074**

Functional and presentation currency

The national currency of the Russian Federation is the Russian Rouble (“RUB”), which is the functional currency of the Group and the currency in which these consolidated financial statements are presented.

Accounting for the effects of hyperinflation

The Russian Federation has previously experienced relatively high levels of inflation and was considered to be hyperinflationary as defined by IAS 29 “Financial Reporting in Hyperinflationary Economies”. IAS 29 requires that financial statements prepared in the currency of a hyperinflationary economy be stated in terms of the measuring unit current at the balance sheet date. Hyperinflation in the Russian Federation ceased effective from 1 January 2003. Restatement procedures of IAS 29 are therefore only applied to assets acquired or revalued and liabilities incurred or assumed prior to that date. For these balances, the amounts expressed in the measuring unit current at 31 December 2002 are treated as the basis for the carrying amounts in these consolidated financial statements.

2.2 Principles of consolidation

The consolidated financial statements comprise the financial statements of the Company and the financial statements of those entities whose operations are controlled by the Company. Control is presumed to exist when the Company has the right to control entities directly or indirectly through subsidiaries.

Subsidiaries are those companies and other entities (including special purpose entities) in which the Company, directly or indirectly, has an interest of more than one half of the voting rights or otherwise has power to govern the financial and operating policies so as to obtain economic benefits. The existence and effect of potential voting rights that are presently exercisable or presently convertible are considered when assessing whether the Company controls another entity. Subsidiaries are consolidated from the date on which control is transferred to the Group (acquisition date) and are deconsolidated from the date that control ceases.

Intercompany transactions, balances and unrealised gains on transactions between group companies are eliminated; unrealised losses are also eliminated unless the cost cannot be recovered. The Company and its subsidiary use uniform accounting policies consistent with the Group’s policies.

The financial statements of subsidiaries are included in the consolidated financial statements from the date that control effectively commences until the date that control effectively ceases. The minority interest has been disclosed as part of equity.

Note 2. Summary of Significant Accounting Policies (Continued)

2.3 Transfers of subsidiaries from parties under common control

Contributions to share capital of shares in subsidiaries from parties under common control are accounted for using the pooling of interest method. Under this method the financial statements of the combined entity are presented as if the businesses had been combined from the beginning of the earliest period presented. The assets and liabilities of the subsidiary transferred under common control are at the predecessor entity's carrying amounts. Any difference between the carrying amount of net assets and the nominal value of share capital and other considerations contributed is accounted for in the consolidated financial statements as an adjustment to equity.

2.4 Foreign currency

Monetary assets and liabilities, which are held by the Group entities and denominated in foreign currencies at the balance sheet date, are translated into Russian Roubles at the official exchange rates of the Central Bank of the Russian Federation prevailing at the respective balance sheet 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 income statement. Translation at year-end rates does not apply to non-monetary items.

As at 31 December 2007, the official rate of exchange, as determined by the Central Bank of the Russian Federation, between the Russian Rouble and the US Dollar ("USD") was RUB 24.5462: USD 1 (31 December 2006 - RUB 26.3311: USD 1), between the Russian Rouble and Euro: RUB 35.9332: EUR 1 (31 December 2006 - RUB 34.6965: EUR 1).

As at the balance sheet date, exchange restrictions and currency controls existed relating to converting the Russian Rouble into other currencies. The Russian Rouble is not freely convertible in most countries outside of the Russian Federation.

2.5 Property, plant and equipment

Property, plant and equipment are stated at cost, restated to the equivalent purchasing power of the Russian Rouble at 31 December 2002 for assets acquired prior to 1 January 2003 (see Note 2.1), less accumulated depreciation and provision for impairment, where required. Cost includes borrowing costs incurred on specific or general funds borrowed to finance construction of qualifying assets.

In 2005 property, plant and equipment were recorded at the carrying values determined in accordance with the IFRS at the date of their transfer to the Group by the Predecessor (RAO UES).

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 fair value less costs to sell 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 income statement. An impairment loss recognised in prior periods is reversed if there has been a change in the estimates used to determine an asset's recoverable amount.

Costs of minor repairs and maintenance are expensed when incurred. Renewals and improvements are capitalised and the assets replaced are retired. Gains and losses arising from the retirement of property, plant and equipment are included in the income statement as incurred.

Social assets are not capitalised 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.

Depreciation of property, plant and equipment is calculated on a straight-line basis over the estimated useful life of the asset when it is available for use. Depreciation commences on the date of acquisition, or in respect of internally constructed assets, from the time the asset is completed and ready for use.

As at 1 January 2007, the Group reviewed the expected pattern of consumption of the future economic benefits embodied in its property, plant and equipment acquired prior to 31 December 2006 and amended their remaining useful economic lives accordingly. The effect of these changes is disclosed in Note 3.

(in thousands of Russian Roubles, except per share amounts)

Note 2. Summary of Significant Accounting Policies (Continued)

The estimated useful lives, in years, of assets by type of facility are as follows:

Type of facility	2007		2006	
	Acquired prior to 31 December 2006*	Acquired subsequent to 31 December 2006	Acquired prior to 31 December 1997*	Acquired subsequent to 31 December 1997
Production buildings	4-50	50	21-32	50
Hydrotechnical buildings	3-50	50	35-44	50
Generating equipment	6-30	20-30	11-31	20-30
Heating networks	3-20	20	13-17	20
Other	3-25	10-25	5-23	10-25

** remaining useful lives as at the date of assessment*

2.6 Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks, and other short-term highly liquid investments with original maturities of three months or less. Cash and cash equivalents are carried at amortised cost using the effective interest method.

2.7 Inventories

Inventories are recorded at the lower of cost and net realisable value. Cost of inventory is determined on the weighted average basis. Net realisable value is the estimated selling price in the ordinary course of business, less the cost of completion and selling expenses.

2.8 Value added tax on purchases and sales

Output value added tax ("VAT") related to sales is payable to tax authorities on the earlier of (a) collection of the receivables from customers or (b) delivery of the goods or services to customers. Input VAT is generally recoverable against output VAT upon receipt of the VAT invoice. The tax authorities permit the settlement of VAT on a net basis. VAT related to sales and purchases is recognised in the balance sheet on a gross basis and disclosed separately as an asset and liability. Where provision has been made for the impairment of receivables, impairment loss is recorded for the gross amount of the debtor, including VAT.

2.9 Accounts receivable

Accounts receivable are recorded inclusive of VAT. Trade receivables are recognised initially at fair value and subsequently measured at amortized cost using the effective interest rate method less provision for impairment. Such a provision for impairment of accounts receivable 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 provision is the difference between the carrying amount and the recoverable amount, being the present value of expected cash flows, discounted at the original effective interest rate. The carrying amount of the asset is reduced through the use of provision for impairment account. When a trade receivable is uncollectible, it is written off against the provision for impairment of trade receivables. Subsequent recoveries of amounts previously written off are credited against operating costs in the income statement. The primary factors that the Group considers whether a receivable is impaired is its overdue status and realisability of related collateral, if any. The following other principal criteria are also used to determine whether there is objective evidence that an impairment loss has occurred:

- any portion of the receivable is overdue and the late payment cannot be attributed to a delay caused by the settlement systems;
- the counterparty experiences a significant financial difficulty as evidenced by its financial information that the Group obtains;
- the counterparty considers bankruptcy or a financial reorganisation;
- there is an adverse change in the payment status of the counterparty as a result of changes in the national or local economic conditions that impact the counterparty;
- the value of collateral, if any, significantly decreases as a result of deteriorating market conditions.

Note 2. Summary of Significant Accounting Policies (Continued)

2.10 Prepayments

Prepayments are carried at cost less provision for impairment. A prepayment is classified as non-current when the goods or services relating to the prepayment are expected to be obtained after one year, or when the prepayment relates to an asset which will itself be classified as non-current upon initial recognition. Prepayments to acquire assets are transferred to the carrying amount of the asset once the Group has obtained control of the asset and it is probable that future economic benefits associated with the asset will flow to the Group. Other prepayments are written off to profit or loss when the goods or services relating to the prepayments are received. If there is an indication that the assets, goods or services relating to a prepayment will not be received, the carrying value of the prepayment is written down accordingly and a corresponding impairment loss is recognised in profit or loss.

2.11 Classification, recognition and measurement of financial assets

The Group classifies its financial assets into the following measurement categories: financial assets at fair value through profit or loss, available-for-sale, held to maturity and loans and receivables.

Financial assets at fair value through profit or loss are securities or other financial assets, which are either acquired for generating a profit from short-term fluctuations in price or trader's margin, or are included in a portfolio in which a pattern of short-term trading exists. Management determines classification of financial assets at fair value through profit or loss upon their initial recognition. Financial assets at fair value through profit or loss are carried at fair value. Changes in fair values of these financial assets are recorded in income statement. Dividends are included in other operating income when the Group's right to receive the dividend payment is established.

Loans and receivables are unquoted non-derivative financial assets with fixed or determinable payments other than those that the Group intends to sell in the near term.

Held to maturity classification includes quoted non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group has both the intention and ability to hold to maturity. Management determines the classification of investment securities held to maturity at their initial recognition and reassesses the appropriateness of that classification at each balance sheet date. Held to maturity investments are carried at amortised cost using the effective interest method, net of a provision for incurred impairment losses.

All other financial assets are included in the available-for-sale category. Available-for-sale investments are carried at fair value. Dividends on available-for-sale equity instruments are recognised in profit or loss when the Group's right to receive payment is established. All other elements of changes in the fair value are deferred in equity until the investment is derecognised or impaired at which time the cumulative gain or loss is transferred from equity to profit or loss.

2.12 Classification of financial liabilities

The Group classifies its financial liabilities into the following measurement categories: (a) held for trading which also includes financial derivatives and (b) other financial liabilities. Liabilities held for trading are carried at fair value with changes in value recognised in the consolidated income statement in the period in which they arise. Other financial liabilities are carried at amortised cost.

2.13 Initial recognition of financial instruments

Trading investments, derivatives and other financial instruments at fair value through profit or loss are initially recorded at fair value. All other financial assets and liabilities are initially recorded at fair value plus transaction costs. Fair value at initial recognition is best evidenced by the transaction price. A gain or loss on initial recognition is only recorded if there is a difference between fair value and transaction price which can be evidenced by other observable current market transactions in the same instrument or by a valuation technique whose inputs include only data from observable markets.

All purchases and sales of financial assets that require delivery within the time frame established by regulation or market convention ("regular way" purchases and sales) are recorded at trade date, which is the date that the Group commits to deliver a financial asset. All other purchases and sales are recognised on the settlement date with the change in value between the commitment date and settlement date not recognised for assets carried at cost or amortised cost; recognised in profit or loss for trading investments; and recognised in equity for assets classified as available for sale.

Note 2. Summary of Significant Accounting Policies (Continued)

2.14 Derecognition of financial assets

The Group derecognises financial assets when (a) the assets are redeemed or the rights to cash flows from the assets otherwise expired or (b) the Group has transferred the rights to the cash flows from the financial assets or entered into a qualifying pass-through arrangement while (i) also transferring substantially all the risks and rewards of ownership of the assets or (ii) neither transferring nor retaining substantially all risks and rewards of ownership but not retaining control. Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without needing to impose additional restrictions on the sale.

2.15 Accounts payable and accrued liabilities

Accounts payable are stated inclusive of VAT. Trade payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest rate method.

2.16 Borrowings

Borrowings are carried at amortised cost using the effective interest method. Interest costs on borrowings to finance the construction of property, plant and equipment are capitalised during the period of time that is required to complete and prepare the asset for its intended use. All other borrowing costs are expensed.

2.17 Minority interest

Minority interest represents the minority shareholders' proportionate share of the equity and results of operations of the Company's subsidiaries. This has been calculated based upon the minority interests' ownership percentage of these subsidiaries. In purchases of minority interest, difference, if any, between the carrying amount of a minority interest and the amount paid to acquire it is recorded directly in equity.

2.18 Provisions for liabilities and charges

Provisions for liabilities and charges are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made. Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Where the Group expects a provision to be reimbursed, for example, under an insurance contract, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

2.19 Pension and post-employment benefits

In the normal course of business the Group contributes to the Russian Federation defined contribution state pension scheme on behalf of its employees. Mandatory contributions to the governmental pension scheme are expensed when incurred.

The Group also operates defined benefit plans. In respect of some of these plans the Group has a contract with a non-governmental pension fund, the other plans are operated by the Group without engaging pension funds.

Cash paid by the Group to the solidarity account with the non-governmental pension fund is refundable to the Group until it is allocated to individual pensioners' bank accounts, and on that basis is accounted for by the Group as an asset (accounts receivable from the pension fund).

Note 2. Summary of Significant Accounting Policies (Continued)

Defined benefit plans determine the amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and compensation. The liability recognised in the balance sheet in respect of defined benefit pension plans operated by the Group is the present value of the defined benefit obligation at the balance sheet date, together with adjustments for unrecognised actuarial gains or losses and past service cost. All defined benefit plans are considered to be fully unfunded. The defined benefit obligations are calculated using the projected unit credit method. The present value of the defined benefit obligations is determined by discounting the estimated future cash outflows using interest rates of government bonds that are denominated in the currency in which the benefits associated with the operations of the plan will be paid, and that have terms to maturity approximating the terms of the related post-employment benefits.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions in excess of the greater of 10% of the value of plan assets or 10% of the defined benefit obligations are charged or credited to the income statement over the employees' expected average remaining working lives.

2.20 Income tax

Income taxes have been provided for in these consolidated financial statements in accordance with the Russian legislation enacted or substantively enacted by the balance sheet date. The income tax charge comprises current tax and deferred tax and is recognised in the income statement unless it relates to transactions that are recognised, in the same or a different period, directly in equity.

Current tax is the amount expected to be paid to or recovered from the taxation authorities in respect of taxable profits or losses for the current and prior periods. Taxes other than on income, are recorded within operating expenses.

Deferred income tax is provided using the balance sheet liability method for tax loss carry forwards and temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. In accordance with the initial recognition exemption, deferred taxes are not recorded for temporary differences on initial recognition of an asset or a liability in a transaction other than a business combination if the transaction, when initially recorded, affects neither accounting nor taxable profit. Deferred tax balances are measured at tax rates enacted or substantively enacted at the balance sheet date which are expected to apply to the period when the temporary differences will reverse or the tax loss carry forwards will be utilised. Deferred tax assets for deductible temporary differences and tax loss carry forwards are recorded only to the extent that it is probable that future taxable profit will be available against which the deductions can be utilised. Deferred tax assets and liabilities are netted only within the individual entities of the Group.

Deferred tax is not provided for the undistributed earnings of the subsidiary, as the Group requires profits to be reinvested, and only insignificant dividends are expected to be declared from future profits of the subsidiary. Neither these future profits nor the related taxes are recognised in these consolidated financial statements.

2.21 Revenue recognition

Revenue is recognised on the delivery of electricity and heat and on the dispatch of non-utility goods and services during the period. Revenue amounts are presented exclusive of VAT. Revenues are measured at the fair value of the consideration received or receivable.

2.22 Operating lease

Where the Group is a lessee in a lease which does not transfer substantially all the risks and rewards incidental to ownership from the lessor to the Group, the total lease payments are charged to income statement on a straight-line basis over the period of the lease. The lease term is the non-cancellable period for which the lessee has contracted to lease the asset together with any further terms for which the lessee has the option to continue to lease the asset, with or without further payment, when at the inception of the lease it is reasonably certain that the lessee will exercise the option.

Note 2. Summary of Significant Accounting Policies (Continued)

2.23 Equity

Share capital. Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction, net of tax, from the proceeds. Any excess of the fair value of consideration received over the par value of shares issued is recorded in equity as share premium.

Merger reserve. The difference between the carrying value of the net assets merged into the Group as a result of the transaction under common control, and the minority interest is recorded in equity, as a merger reserve.

Treasury shares. Where the Company purchases its equity share capital, the consideration paid, including any directly attributable incremental costs (net of income taxes), is deducted from equity attributable to the Company's equity holders until the shares are cancelled, reissued or disposed of. Where such shares are subsequently sold or reissued, any consideration received, net of any directly attributable incremental transaction costs and the related income tax effects, is included in equity attributable to the Company's equity holders.

Dividends. Dividends are recognised as a liability and deducted from equity at the balance sheet date only if they are declared before or on the balance sheet date. Dividends are disclosed when they are proposed before the balance sheet date or proposed or declared after the balance sheet date but before the financial statements are authorised for issue.

2.24 Environmental liabilities

Liabilities for environmental remediation are recorded where there is a present obligation, the payment is probable and reliable estimates can be made.

2.25 Earnings per share

Earnings per share are determined by dividing the profit attributable to ordinary shareholders of the Group by the weighted average number of ordinary shares outstanding during the reporting period.

2.26 Segment reporting

The Group operates predominantly in a single geographical area and industry, the generation of electric power and heat in the North-West of the Russian Federation. The generation of electricity and heat are related activities and are subject to similar risks and returns, therefore they are reported as one business segment.

2.27 Seasonality

Demand for electricity and heat is influenced by both the seasons of the year and the relative severity of the weather. Revenues from sales of heat are concentrated within the months of October to March. A similar, although less intense, 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.

2.28 Interest

Interest income and expense are recognised in the income statement for all interest bearing instruments on an accrual basis using the effective interest rate method. Interest income includes nominal interest and accrued discount and premium. When loans become doubtful for collection, they are written down to their recoverable amounts and interest income is thereafter recognised based on the rate of interest that was used to discount the future cash flows for the purpose of measuring the recoverable amount.

Note 2. Summary of Significant Accounting Policies (Continued)

2.29 Adoption of new or revised standards and interpretations

Certain new IFRSs became effective for the Group from 1 January 2007. Listed below are those new or amended standards or interpretations which are or in the future could be relevant to the Group's operations, and the nature of their impact on the Group's accounting policies. All changes in accounting policies were applied retrospectively with adjustments made to retained earnings at 1 January 2006, unless otherwise described below.

IFRS 7, Financial Instruments: Disclosures and a complementary Amendment to IAS 1, Presentation of Financial Statements - Capital Disclosures (effective from 1 January 2007). The IFRS introduced new disclosures to improve the information about financial instruments, including about quantitative aspects of risk exposures and the methods of risk management. The new quantitative disclosures provide information about the extent of exposure to risk, based on information provided internally to the entity's key management personnel. Qualitative and quantitative disclosures cover exposure to credit risk, liquidity risk and market risk including sensitivity analysis to market risk. IFRS 7 replaced IAS 30, *Disclosures in the Financial Statements of Banks and Similar Financial Institutions*, and some of the requirements in IAS 32, *Financial Instruments: Disclosure and Presentation*. The Amendment to IAS 1 introduced disclosures about the level of an entity's capital and how it manages capital. The new disclosures are made in these consolidated financial statements.

Other new standards or interpretations. The Group has adopted the following interpretations which became effective from 1 January 2007:

- IFRIC 7, *Applying the Restatement Approach under IAS 29* (effective for periods beginning on or after 1 March 2006);
- IFRIC 8, *Scope of IFRS 2* (effective for periods beginning on or after 1 May 2006);
- IFRIC 9, *Reassessment of Embedded Derivatives* (effective for annual periods beginning on or after 1 June 2006);
- IFRIC 10, *Interim Financial Reporting and Impairment* (effective for annual periods beginning on or after 1 November 2006).

The effect of adoption of the above new standards and interpretations on the Group's financial position at 31 December 2007 and 31 December 2006 and on the results of its operations for the year ended 31 December 2007 and 31 December 2006 was not significant.

Note 3. Critical Accounting Estimates and Judgements in Applying Accounting Policies

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities. Estimates and judgements are continually evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Management also makes certain judgements, apart from those involving estimations, in the process of applying the accounting policies. Judgements that have the most significant effect on the amounts recognised in the consolidated financial statements, and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities within the next financial year include:

Provision for impairment of property, plant and equipment

At each balance sheet date the Group assesses whether there is any indication that the recoverable amount of the Group's assets has declined below their carrying value. The recoverable amount of property, plant and equipment is the higher of an asset's fair value less costs to sell and its value in use. When such a decline is identified, the carrying amount is reduced to the recoverable amount. The amount of the reduction is recorded in the consolidated income statement in the period in which the reduction is identified. If conditions change and management determines that the value of an asset other than goodwill has increased, the impairment provision will be fully or partially reversed.

(in thousands of Russian Roubles, except per share amounts)

Note 3. Critical Accounting Estimates and Judgements in Applying Accounting Policies (Continued)

Management considered recent favourable changes in operation of the Russian electricity market (see also Note 1.4) and reassessed recoverable amount of the Group's property, plant and equipment as at 31 December 2007. As a result, management believes that provision for impairment of property, plant and equipment previously recorded by the Group in respect of electricity and heat generating assets should be partially reversed as at 31 December 2007. The amount of reversal is estimated by management as RUB 3 824 248 thousand. The future tariff estimates used by management in forecasting future cash flows are based on the Scenario of Economic Performance of the Russian Federation and the Key Parameters of Forecasting Social and Economic Development of the Russian Federation for 2009 and the 2010-2011 Planning Period, approved by the Ministry of Economic Development of the Russian Federation in May 2008, and are significantly higher than those used in the previous year. The increased forecasted tariffs had the most significant positive impact on the projected cash flows of hydro-electric power stations of Nevsky branch and Heating Networks, where the increased revenue forecast are not offset by the corresponding fuel cost increases, so there has been a release of impairment provision related to the HPS of Nevsky branch and Heating Networks of RUB 1 049 853 thousand and RUB 1 905 382 thousand respectively. On the other hand, management recognised further impairment loss in respect of the property, plant and equipment of TPP of Nevsky Branch in the amount of RUB 55 501 thousand (see also Note 6).

Management made the following significant assumptions when estimating the value in use of property, plant and equipment and determining the levels of impairment provisions as at 31 December 2007:

- average remaining useful lives have been estimated by management for separate cash generating units on the basis of a report by a consortium of independent appraisers as at 31 December 2006 and taking into account the latest capital investment programme of the Group, as follows:

Name of cash generating unit	Average remaining useful lives, years
Kolsky branch (HPS)	12
Karelsky branch (HPS)	13
Apatitskaya Thermal Power Plant (TPP)	7
HPS of Nevsky branch	13
TPP of Nevsky branch	10
Heating Network of Nevsky branch	10
Murmanskaya TPP	4

- increase in average selling price for electricity is 17% for 2008; further expected increase of average selling price for electricity is estimated by the management as 19%-24% p.a. in 2009-2011 and 9%-11% p.a. in 2012 and onwards;
- increase in average selling price for heat is 18% for 2008 for all of the Group's cash generating units except for Murmanskaya TPP; further expected increase of average selling price for heat is estimated by the management as 18%-23% p.a. in 2009-2011 and 7% p.a. in 2012 and onwards. The average selling price for heat at Murmanskaya TPP is expected to increase by 16% p.a. in 2008-2011;
- expected increase in fuel prices was estimated by management as 12% p.a. for coal at Apatitskaya TPP and 28% p.a. for gas at TPP of Nevsky branch on average in 2008-2011; 6% p.a. for coal at Apatitskaya TPP and 8% p.a. for gas at TPP of Nevsky branch in 2012 and onwards;
- production volumes of electricity will remain at the current level for Karelsky branch, Kolsky branch and HPS of Nevsky branch. For other cash generating units, management expects increases in heat and electricity volumes within the range of 1% to 10% over the period of the forecast. This increase is applied to the existing production capacity (investment programme is not included);
- for the cash generating unit Heating Network of Nevsky Branch the increase in tariffs for heat transportation was estimated in proportion to the heat tariffs increase;
- repair and maintenance expenses of Heating Network of Nevsky Branch were estimated on the basis of repair cost per 1 km of pipelines (RUB 49 890 thousand) applied to 40 km of heating networks requiring repairs on an annual basis. The total length of heat pipelines for Heating Network of Nevsky branch is approximately 800 km;

(in thousands of Russian Roubles, except per share amounts)

Note 3. Critical Accounting Estimates and Judgements in Applying Accounting Policies (Continued)

- weighted average cost of capital of 10.23% was applied for discounting future operating cash flows generated by the Group from all cash generating units.

Variations in the above assumptions may give rise to a significantly different amount for the impairment provision. In particular:

- Should the annual growth rate of the selling price for electricity and heat be increased/decreased by 10% then an estimate of the recoverable amount would result in a decrease/increase in the impairment provision of RUB (8 755 498)/7 823 021 thousand as at 31 December 2007;
- Should the annual growth rate of the operating expenses, including fuel costs, be increased/decreased by 10% then an estimate of the recoverable amount would result in an increase/decrease in the impairment provision of RUB 7 372 048/(8 213 639) thousand as at 31 December 2007;
- Should the remaining useful economic lives of property, plant and equipment be increased/ decreased by 10%, then an estimate of the recoverable amount would result in a decrease/ increase in the impairment provision of RUB (1 266 487)/1 184 374 thousand as at 31 December 2007;
- Should the weighted average cost of capital be increased/decreased by 10%, then an estimate of the recoverable amount would result in an increase/decrease in the impairment provision of RUB 688 688/(743 389) thousand as at 31 December 2007.

In management's opinion, the existing provision represents the best estimate of the impact of impairment as a result of the current economic conditions affecting the Group.

As at 31 December 2006, management also considered recent favorable changes in operation of the Russian electricity market and reassessed recoverable amount of the Group's property, plant and equipment. As a result, management concluded that provision for impairment of property, plant and equipment recorded by the Group as at 31 December 2005 in respect of electricity and heat generating assets using the predecessor accounting basis of RAO UES had to be partially reversed. The amount of reversal as at 31 December 2006 was estimated by management as RUB 8 025 359 thousand. On the other hand, management considered further obsolescence of the Heating Network and TPP of Nevsky Branch as at 31 December 2006 and recognised further impairment loss in respect of the property, plant and equipment of these cash generating units in the amount of RUB 5 993 876 thousand.

The significant assumptions made by management when estimating the value in use of property, plant and equipment and determining the levels of impairment provisions as at 31 December 2006, were as follows:

- average remaining useful lives were estimated by management as follows:

Name of cash generating unit	Average remaining useful lives, years
Kolsky branch (HPS)	24
Karelsky branch (HPS)	25
Apatitskaya Thermal Power Plant (TPP)	9
HPS of Nevsky branch	6
TPP of Nevsky branch	11
Heating Network of Nevsky branch	11
Murmanskaya TPP	10

- increase in electricity tariffs set for the Company for 2007 was on average 26%; further expected increase in tariffs was estimated by management as 13%-20% p.a. in 2008-2011 and 3%-4% p.a. in 2012 and onwards;
- increase in heat tariffs set for the Company for 2007 were on average 15% and 18% for Murmanskaya TPP; further expected increase in tariffs was estimated by management as 10%-16% p.a. in 2008-2011 and 15%-20% for Murmanskaya TPP; 5%-7% p.a. in 2012-2013 and 3%-4% p.a. in 2014 and onwards;
- growth of gas prices set in the Government's forecast was not expected to exceed the limit of 15% in 2007, which did not significantly exceed the expected inflation;
- growth of coal prices set in the Government's forecast was not expected to exceed the limit of 8.9% in 2007;

Note 3. Critical Accounting Estimates and Judgements in Applying Accounting Policies (Continued)

- increase of mazut prices as set by the financial plan approved by the Board of Directors of TGC-1 on the level of 19% for 2007;
- for Murmanskaya TPP mazut costs for the year 2007 were taken on the basis of actual prices for the first half of 2007 and price forecast for the second half of 2007; further increase in mazut costs was estimated as 7% for 2008, 9% p.a. for 2009-2010, 7-8% p.a. for 2011-2015 and 4% for 2016
- average expected increase in fuel prices was estimated by the management on average as 8% p.a. (for coal for Apatitskaya TPP) and 19% p.a. (for all other TPPs) in 2008-2010 and 3% p.a. for both coal and gas TPPs in 2011 and onwards;
- the assumption was made that production volumes of electricity and heat will remain at the current level for the whole impairment test period (investment programme was not included);
- for the cash generating unit Heating Network of Nevsky Branch the increase in tariffs for heat transportation was estimated in proportion to the heat tariffs increase;
- repair and maintenance expenses of cash generating unit Heating Network of Nevsky Branch on the basis of repair cost of 1 km of pipelines (RR 49 890 thousand) applied to 40 km of heating networks requiring repairs on annual basis. Total length of heat pipelines for Heating network of Nevsky branch is approximately 800 km;
- weighted average cost of capital of 12.02% was applied for discounting future operating cash flows generated by the Company for all cash generating units;
- the Company's restructuring did not change the manner of recovery of the assets – the regulator allocated previously single tariffs for electricity and heat set for vertically integrated power companies among newly created generating businesses.

Estimated fair value of available-for-sale investment

Management has estimated the fair value of a 3.0685% equity interest in OJSC North-West Thermal Power Plant ("NWTPP") for the purpose of these consolidated financial statements on the basis of a valuation performed by a consortium of independent appraisers. The fair value of the investment was determined primarily using the discounted cash flow method.

The following key assumptions were applied by the appraisers:

- Cash flow projections were based on the actual operating results and a ten-year business plan of NWTPP. Increase of revenues and expenses beyond the ten-year period was extrapolated on the basis of expected inflation rate of 2.7% p.a.;
- Discount rates of 13.3%-12.3% were applied in 2008-2010 and discount rate of 12.1% was applied in 2011-2016 in determining the recoverable amount of the investment. These discount rates were estimated on the basis of the weighted average cost of capital;
- Minority discount of 19.46% was applied.

Variations in these assumptions may give rise to a significantly different amount for the carrying value of the investment in NWTPP. In management's opinion, the valuation performed by the independent appraisers represents the best estimate of the fair value of this investment in the current economic conditions affecting the Group.

Useful lives of property, plant and equipment

The estimation of the useful life of an item of property, plant and equipment is a matter of management's judgement based upon experience with similar assets. In determining the useful life of an asset, management considers the expected usage, estimated technical obsolescence, physical wear and tear and the physical environment in which the asset is operated. Changes in any of these conditions or estimates may result in adjustments for future depreciation rates.

As described in Note 2.5, as at 1 January 2007 management reviewed the expected pattern of consumption of the future economic benefits embodied in its property, plant and equipment acquired prior to 31 December 2006 and amended their remaining useful economic lives accordingly.

(in thousands of Russian Roubles, except per share amounts)

Note 3. Critical Accounting Estimates and Judgements in Applying Accounting Policies (Continued)

The management estimates were based on a report by a consortium of independent appraisers as at 31 December 2006. The estimated useful lives of assets by type of facility as applied by the Group are disclosed in Note 2.5. The effect of this change in estimates is reflected in the consolidated income statement for the year ended 31 December 2007 and is RUB 445 299 thousand increase in the depreciation charge for the year. It is impracticable to determine the effect which this change in estimate will have on the future accounting periods.

Were the estimated useful lives to differ by 10% from management's estimates, the impact on depreciation for the year would be to increase it by RUB 214 018 thousand or reduce it by RUB 178 154 thousand (Note 6).

Recoverability of accounts receivable

Provision for impairment of accounts receivable is based on the Group's assessment of whether the collectibility of specific customer accounts worsened compared to previous period estimates. If there is a deterioration in a major customer's creditworthiness or actual defaults are higher than the estimates, the actual results could differ from these estimates (see also Note 26).

Tax legislation

Russian tax, currency and customs legislation is subject to varying interpretations (Note 25).

Pension obligation

The principal actuarial assumptions used to calculate the defined benefit obligation as at 31 December 2007 are listed in Note 16. The impact of potential changes in these assumptions is as follows:

	Increase in the present value of the defined benefit obligation as at 31 December 2007
Discount rate lower by 0.75 % p.a.	8%
Salary rate increase of 0.75% p.a.	1%
Inflation (pension rate) increase of 0.75% p.a.	7%
Withdrawal rate lower by 1.5% p.a.	3%

Note 4. New Accounting Pronouncements

Certain new standards and interpretations have been published that are mandatory for the Group's accounting periods beginning on or after 1 January 2008 or later periods and which the Group has not early adopted:

IFRS 8, Operating Segments (effective for annual periods beginning on or after 1 January 2009). The standard applies to entities whose debt or equity instruments are traded in a public market or that file, or are in the process of filing, their financial statements with a regulatory organisation for the purpose of issuing any class of instruments in a public market. IFRS 8 requires an entity to report financial and descriptive information about its operating segments and specifies how an entity should report such information. The Group is currently assessing what impact the standard will have on the consolidated financial statements.

Puttable financial instruments and obligations arising on liquidation—IAS 32 and IAS 1 Amendment (effective from 1 January 2009). The amendment requires classification as equity of some financial instruments that meet the definition of a financial liability. The Group does not expect the amendment to affect its consolidated financial statements.

IAS 23, Borrowing Costs (revised March 2007; effective for annual periods beginning on or after 1 January 2009). The main change to IAS 23 is the removal of the option of immediately recognising as an expense borrowing costs that relate to assets that take a substantial period of time to get ready for use or sale. An entity is, therefore, required to capitalise such borrowing costs as part of the cost of the asset. The revised standard applies prospectively to borrowing costs relating to qualifying assets for which the commencement date for capitalisation is on or after 1 January 2009. The Group does not expect that the impact of the new standard will be significant as its current policy is to capitalise borrowing costs related to the assets that take a substantial period of time to get ready for use or sale.

Note 4. New Accounting Pronouncements (Continued)

IAS 1, Presentation of Financial Statements (revised September 2007; effective for annual periods beginning on or after 1 January 2009). The main change in IAS 1 is the replacement of the income statement by a statement of comprehensive income which will also include all non-owner changes in equity, such as the revaluation of available-for-sale financial assets. Alternatively, entities will be allowed to present two statements: a separate income statement and a statement of comprehensive income. The revised IAS 1 also introduces a requirement to present a statement of financial position (balance sheet) at the beginning of the earliest comparative period whenever the entity restates comparatives due to reclassifications, changes in accounting policies, or corrections of errors. The Group expects the revised

IAS 1 to affect the presentation of its consolidated financial statements but to have no impact on the recognition or measurement of specific transactions and balances.

Vesting Conditions and Cancellations—Amendment to IFRS 2, Share-based Payment (issued in January 2008; effective for annual periods beginning on or after 1 January 2009). The amendment clarifies that only service conditions and performance conditions are vesting conditions. Other features of a share-based payment are not vesting conditions. The amendment specifies that all cancellations, whether by the entity or by other parties, should receive the same accounting treatment. The Group does not expect the amendment to affect its consolidated financial statements.

IAS 27, Consolidated and Separate Financial Statements (revised January 2008; effective for annual periods beginning on or after 1 July 2009). The revised IAS 27 will require an entity to attribute total comprehensive income to the owners of the parent and to the non-controlling interests (previously "minority interests") even if this results in the non-controlling interests having a deficit balance (the current standard requires the excess losses to be allocated to the owners of the parent in most cases). The revised standard specifies that changes in a parent's ownership interest in a subsidiary that do not result in the loss of control must be accounted for as equity transactions. It also specifies how an entity should measure any gain or loss arising on the loss of control of a subsidiary. At the date when control is lost, any investment retained in the former subsidiary will have to be measured at its fair value. The Group is currently assessing the impact of the revised Standard.

IFRS 3, Business Combinations (revised January 2008; effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009). The revised IFRS 3 will allow entities to choose to measure non-controlling interests using the existing IFRS 3 method (proportionate share of the acquiree's identifiable net assets) or on the same basis as US GAAP (at fair value). The revised IFRS 3 is more detailed in providing guidance on the application of the purchase method to business combinations. The requirement to measure at fair value every asset and liability at each step in a step acquisition for the purposes of calculating a portion of goodwill has been removed. Instead, goodwill will be measured as the difference at acquisition date between the fair value of any investment in the business held before the acquisition, the consideration transferred and the net assets acquired. Acquisition-related costs will be accounted for separately from the business combination and therefore recognised as expenses rather than included in goodwill. An acquirer may have to recognise at the acquisition date a liability for any contingent purchase consideration. Changes in the value of that liability after the acquisition date will be recognised in accordance with other applicable IFRSs, as appropriate, rather than by adjusting goodwill. The Group is currently assessing the impact of the revised Standard.

IFRIC 13, Customer Loyalty Programmes (issued in June 2007; effective for annual periods beginning on or after 1 July 2008). IFRIC 13 clarifies that where goods or services are sold together with a customer loyalty incentive (for example, loyalty points or free products), the arrangement is a multiple-element arrangement and the consideration receivable from the customer is allocated between the components of the arrangement using fair values. IFRIC 13 is not relevant to the Group's operations because the Group does not operate any loyalty programmes.

Improvements to International Financial Reporting Standards (issued in May 2008). In 2007, the International Accounting Standards Board decided to initiate an annual improvements project as a method of making necessary, but non-urgent, amendments to IFRS. The amendments issued in May 2008 consist of a mixture of substantive changes, clarifications, and changes in terminology in various standards. The substantive changes relate to the following areas: classification as held for sale under IFRS 5 in case of a loss of control over a subsidiary; possibility of presentation of financial instruments held for trading as non-current under IAS 1; accounting for sale of IAS 16 assets which were previously held for rental and classification of the related cash flows under IAS 7 as cash flows from operating activities; clarification of definition of a curtailment under IAS 19; accounting for below market interest

Note 4. New Accounting Pronouncements (Continued)

rate government loans in accordance with IAS 20; making the definition of borrowing costs in IAS 23 consistent with the effective interest method; clarification of accounting for subsidiaries held for sale under IAS 27 and IFRS 5; reduction in the disclosure requirements relating to associates and joint ventures under IAS 28 and IAS 31; enhancement of disclosures required by IAS 36; clarification of accounting for advertising costs under IAS 38; amending the definition of the fair value through profit or loss category to be consistent with hedge accounting under IAS 39; introduction of accounting for investment properties under construction in accordance with IAS 40; and reduction in restrictions over manner of determining fair value of biological assets under IAS 41. Further amendments made to IAS 8, 10, 18, 20, 29, 34, 40, 41 and to IFRS 7 represent terminology or editorial changes only, which the IASB believes have no or minimal effect on accounting. The Group does not expect the amendments to have any material effect on its consolidated financial statements.

Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate—IFRS 1 and IAS 27 Amendment (revised May 2008; effective for annual periods beginning on or after 1 January 2009). The amendment allows first-time adopters of IFRS to measure investments in subsidiaries, jointly controlled entities or associates at fair value or at previous GAAP carrying value as deemed cost in the separate financial statements. The amendment also requires distributions from pre-acquisition net assets of investees to be recognised in profit or loss rather than as a recovery of the investment. The amendment will not have an impact on the Group’s consolidated financial statements.

Other new standards or interpretations. The Group has not early adopted the following other new standards or interpretations:

- IFRIC 11, *IFRS 2 - Group and Treasury Share Transactions* (effective for annual periods beginning on or after 1 March 2007);
- IFRIC 12, *Service Concession Arrangements* (effective for annual periods beginning on or after 1 January 2008);
- IFRIC 14, *IAS 19—The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* (effective for annual periods beginning on or after 1 January 2008).

Unless otherwise described above, the new standards and interpretations are not expected to significantly affect the Group’s consolidated financial statements.

Note 5. Related Parties

Related parties are defined in IAS 24, *Related Party Disclosures*. Parties are generally considered to be related if one party has the ability to control the other party, is under common control, or can exercise significant influence or joint control over the other party in making financial and operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

Related parties include shareholders that have control or significant influence over the Company, and directors, as well as companies that are controlled by the State. RAO UES is the main shareholder of the Company and had control over the Group’s activity until October 2007 (see Note 1.3).

The nature of the related party relationships for those related parties with whom the Group entered into significant transactions in the years ended 31 December 2007 and 31 December 2006, and had significant balances outstanding at 31 December 2007 and at 31 December 2006 are detailed below.

5.1 RAO UES

As at 31 December 2007 and 31 December 2006 the Group had a liability to RAO UES, for dividends declared but not paid in the amount of RUB 903 thousand and RUB 37 049 thousand, respectively.

In July 2007 the Group sold 185 639 860 ordinary shares or 2.57% of equity capital of OJSC Power Machines to RAO UES for a consideration of RUB 795 965 thousand (see Note 7).

(in thousands of Russian Roubles, except per share amounts)

Note 5. Related Parties (Continued)

5.2 RAO UES's subsidiaries

Transactions with RAO UES's subsidiaries were as follows:

	Year ended 31 December 2007	Year ended 31 December 2006
Sales of electricity and heating	10 083 463	8 750 603
Other sales	18 876	57 819
Total sales	**10 102 339**	**8 808 422**
Purchases of electricity	411 243	111 978
Agency commission	-	24 835
Repairs and maintenance	-	54 803
Operating lease	185 517	-
Compensation payments	-	13 334
Other purchases	482 667	1 271
Total expenses	**1 079 427**	**206 221**

Balances with RAO UES's subsidiaries at the end of the period were as follows:

	31 December 2007	31 December 2006
Accounts receivable and prepayments	431 354	167 483
Accounts payable and accrued liabilities	138 963	141 031

As at 31 December 2007 the Group had not issued any guarantees in respect of borrowings drawn down by RAO UES's subsidiaries (31 December 2006: guarantees issued for RUB 180 303 thousand).

5.3 State-controlled entities

In the normal course of business the Group enters into transactions with other entities under Government control. Prices for natural gas, electricity and heat are based on tariffs set by FST and RSTs. Bank loans are obtained at market rates. Taxes are charged and paid under the Russian tax legislation.

The Group had the following significant transactions with state-controlled entities (excluding RAO UES and its subsidiaries):

	Year ended 31 December 2007	Year ended 31 December 2006
Sales of heating	10 724 732	10 552 267
Sales of electricity	3 587 796	530 932
Total sales	**14 312 528**	**11 083 199**
Fuel	9 153 211	7 754 223
Water usage expenses	1 501 438	1 550 476
Electricity purchases	2 166 589	1 048 512
Heat distribution	985 111	919 514
Heat purchases	145 860	161 552
Interest expense	41 765	66 109
Security services	-	14 635
Railway transportation	15 672	28 024
Other	-	6 477
Total expenses	**14 009 646**	**11 549 522**

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

	31 December 2007	31 December 2006
Accounts receivable and prepayments	2 817 020	2 189 965
Borrowings	-	1 444 590
Accounts payable and accrued liabilities	854 857	403 729
Cash and cash equivalents	12 708 088	41 368

(in thousands of Russian Roubles, except per share amounts)

Note 5. Related Parties (Continued)

5.4 Transactions with other related parties

The Group had the following significant transactions and balances with the shareholder Fortum Power and Heat Oy which has significant influence over Group:

	Year ended 31 December 2007	Year ended 31 December 2006
Sales of electricity	213 717	326 744
Interest expense	77 740	-

	31 December 2007	31 December 2006
Accounts receivable and prepayments	9 937	37 621
Accounts payable and accrued liabilities	-	3 601

As at 22 December 2006, a long-term loan of RUB 1 040 895 thousand was received from Nordic Investment Bank (related to the Company's shareholder Fortum Power and Heat Oy). For detailed information about long-term borrowings, please see Note 15.

Transactions and balances with the Non-state pension fund of electrical energy industry are disclosed in Note 16.

5.5 Transactions with the Board of Directors and key management personnel

Total remuneration in the form of salary and bonuses paid to the members of the Board of Directors and key management personnel for the year ended 31 December 2007, was RR 142 258 thousand (2006: RUB 76 739 thousand). All remuneration falls under short-term employee benefits definition in IAS 19 "Employee Benefits".

(in thousands of Russian Roubles, except per share amounts)

Note 6. Property, Plant and Equipment

Cost	Production buildings	Hydrotechnical buildings	Generating equipment	Heating networks	Construction in progress	Other	Total
Balance as at 31 December 2006	14 431 488	16 425 434	11 416 972	22 625 155	3 232 989	14 279 813	82 411 851
Additions	22 912	-	32 934	3 586	13 496 657	315 515	13 871 604
Transfers	73 492	9 529	541 457	3 619 488	(4 839 781)	595 815	-
Disposals	(2 596)	-	(7 734)	(756 725)	(9 898)	(239 866)	(1 016 819)
Balance as at 31 December 2007	**14 525 296**	**16 434 963**	**11 983 629**	**25 491 504**	**11 879 967**	**14 951 277**	**95 266 636**
Accumulated depreciation (including impairment)							
Balance as at 31 December 2006	(6 608 623)	(5 498 293)	(7 713 953)	(21 682 719)	-	(11 338 671)	(52 842 259)
Charge for the year	(382 917)	(482 200)	(612 237)	(171 893)	-	(395 574)	(2 044 821)
Disposals	221	-	4 359	708 550	-	111 895	825 025
Impairment losses reversed/ (recognised) during the year (Note 3)	1 136 310	412 241	1 603 795	565 076	-	51 325	3 768 747
Balance as at 31 December 2007	**(5 855 009)**	**(5 568 252)**	**(6 718 036)**	**(20 580 986)**	**-**	**(11 571 025)**	**(50 293 308)**
Net book value as at 31 December 2006	7 822 865	10 927 141	3 703 019	942 436	3 232 989	2 941 142	29 569 592
Net book value as at 31 December 2007	**8 670 287**	**10 866 711**	**5 265 593**	**4 910 518**	**11 879 967**	**3 380 252**	**44 973 328**

Cost	Production buildings	Hydrotechnical buildings	Generating equipment	Heating networks	Construction in progress	Other	Total
Balance as at 31 December 2005	13 607 159	16 403 925	9 549 583	20 953 867	7 726 976	11 183 419	79 424 929
Additions	8 377	-	4 613	120	3 580 361	88 716	3 682 187
Transfers	1 006 932	21 509	1 871 193	1 694 592	(7 981 990)	3 387 764	-
Disposals	(190 980)	-	(8 417)	(23 424)	(92 358)	(380 086)	(695 265)
Balance as at 31 December 2006	**14 431 488**	**16 425 434**	**11 416 972**	**22 625 155**	**3 232 989**	**14 279 813**	**82 411 851**
Accumulated depreciation (including impairment)							
Balance as at 31 December 2005	(9 567 727)	(10 275 153)	(7 999 674)	(16 931 726)	-	(9 166 550)	(53 940 830)
Charge for the year	(186 903)	(183 646)	(204 262)	(497 038)	-	(352 095)	(1 423 944)
Disposals	159 514	-	2 671	20 391	-	308 456	491 032
Impairment losses reversed/ (recognised) during the year (Note 3)	2 986 493	4 960 506	487 312	(4 274 346)	-	(2 128 482)	2 031 483
Balance as at 31 December 2006	**(6 608 623)**	**(5 498 293)**	**(7 713 953)**	**(21 682 719)**	**-**	**(11 338 671)**	**(52 842 259)**
Net book value as at 31 December 2005	4 039 432	6 128 772	1 549 909	4 022 141	7 726 976	2 016 869	25 484 099
Net book value as at 31 December 2006	**7 822 865**	**10 927 141**	**3 703 019**	**942 436**	**3 232 989**	**2 941 142**	**29 569 592**

(in thousands of Russian Roubles, except per share amounts)

Note 6. Property, Plant and Equipment (Continued)

Construction in progress represents the carrying amount of property, plant and equipment that has not yet been made available for use in production, including generating stations under construction.

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

Property, plant and equipment with net book value of RUB 355 880 thousand were pledged as collateral according to loan agreements (31 December 2006: RUB 573 941 thousand) (see Note 15).

Impairment. As described in Note 3, management assessed the recoverability of property, plant and equipment as at 31 December 2007. Value in use was estimated through a review of discounted future cash flows for seven cash-generating units. The significant assumptions applied by management and the results of this impairment assessment are disclosed in Note 3.

Operating lease

The Group leases a number of land plots owned by local governments under operating leases. Land lease commitments are determined by lease agreements and were as follows:

	31 December 2007	31 December 2006
Not later than one year	51 468	42 984
Later than one year and not later than five years	212 568	174 478
Later than five years	1 412 721	1 160 150
Total	**1 676 757**	**1 377 612**

Note 7. Long-term Investments

	% ownership	31 December 2007	31 December 2006
Held at fair value through profit or loss:			
Equity shares in OJSC Power Machines	2.57%	-	890 232
Available-for-sale investments:			
Equity shares in NWTPP	3.07%	220 553	399 948
Other investments		20 000	4 850
Total investments		**240 553**	**1 295 030**

In July 2007 the Group sold 185 639 860 ordinary shares or 2.57% of equity capital of OJSC Power Machines to RAO UES for a consideration of RUB 795 965 thousand. The financial result of this transaction is included in Other operating expenses as a change in financial assets at fair value through profit or loss (Note 20).

Available-for-sale investments include shares in NWTPP, entity controlled by RAO UES, which are not publicly traded. Management estimated fair value of these shares as at reporting date on the basis of independent appraisal (see Note 3). The result from the re-measurement of this investment to its fair value is recognised directly in Equity, in fair value reserve.

(in thousands of Russian Roubles, except per share amounts)

Note 8. Income Tax

	Year ended 31 December 2007	Year ended 31 December 2006
Current income tax charge	-	18 128
Deferred income tax charge	1 098 298	575 381
Income tax charge	**1 098 298**	**593 509**

In 2007 and 2006 the Group was subject to a 24% income tax rate on taxable profits.

Reconciliation between the expected and the actual taxation charge is provided below:

	Year ended 31 December 2007	Year end 31 December 20
Profit before tax	3 495 477	1 739 89
Theoretical tax charge at the statutory tax rate of 24%	838 914	417 57
Tax effects of items which are non-deductible for income tax purposes	259 384	175 93
Income tax charge	**1 098 298**	**593 50**

Deferred tax assets and liabilities

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 their tax bases. Deferred tax assets and liabilities are measured at the rate of 24% which is expected to be applied to the period when the assets are realised and liabilities are settled.

In the context of the Group's current structure, tax losses and current tax assets of different consolidated entities may not be offset against current tax liabilities and taxable profits of other consolidated entities and, accordingly, taxes may accrue even where there is a consolidated tax loss. Therefore, deferred tax assets and liabilities are offset only when they relate to the same taxable entity.

Deferred tax liabilities:	31 December 2006	(Charged)/ credited to income statement	Credited to equity	Disposal of subsidiaries	31 December 2007
Property, plant and equipment	(1 668 803)	(1 172 343)	-	14 705	(2 826 441)
Investments	(187 331)	116 191	43 055	-	(28 085)
Accounts receivable (including long-term receivables)	(77 563)	(40 574)	-	-	(118 137)
Accounts payable and accrued liabilities	137 474	16 895	-	-	154 369
Tax loss carried forward	183 419	(34 746)	-	-	148 673
Other	34 678	31 235	-	-	65 913
Total deferred tax liability	**(1 578 126)**	**(1 083 342)**	**43 055**	**14 705**	**(2 603 708)**

Deferred tax liabilities:	31 December 2005	(Charged)/ credited to income statement	Charged to equity	Disposal of subsidiaries	31 December 2006
Property, plant and equipment	(943 490)	(687 815)	-	(37 498)	(1 668 803)
Investments	(62 914)	(113 131)	(11 286)	-	(187 331)
Accounts receivable (including long-term receivables)	24 911	(102 474)	-	-	(77 563)
Accounts payable and accrued liabilities	131 058	6 416	-	-	137 474
Tax loss carried forward	-	183 419	-	-	183 419
Other	20 289	12 782	-	1 607	34 678
Total deferred tax liability	**(830 146)**	**(700 803)**	**(11 286)**	**(35 891)**	**(1 578 126)**

(in thousands of Russian Roubles, except per share amounts)

Note 8. Income Tax (Continued)

Deferred tax assets	31 December 2006	(Charged)/ credited to income statement	31 December 2007
Property, plant and equipment	32 386	(49 098)	(16 712)
Tax loss carried forward	156 351	65 796	222 147
Accounts receivable	10 146	(5 931)	4 215
Accounts payable and accrued liabilities	10 822	(24 391)	(13 569)
Other	6 212	(1 331)	4 881
Total deferred tax assets	**215 917**	**(14 955)**	**200 962**

Deferred tax assets	31 December 2005	(Charged)/ credited to income statement	31 December 2006
Accounts receivable	9 810	336	10 146
Accounts payable and accrued liabilities	7 799	3 023	10 822
Property, plant and equipment	48 303	(15 917)	32 386
Tax loss carried forward	17 503	138 848	156 351
Other	7 080	(868)	6 212
Total deferred tax assets	**90 495**	**125 422**	**215 917**

Note 9. Other Non-Current Assets

	31 December 2007	31 December 2006
Long-term receivables (interest free)	159 935	78 045
Loans issued (at 10% interest rate)	34 014	32 668
Total financial receivables	**193 949**	**110 713**
Prepayments for property, plant and equipment	1 270 970	-
Total other non-current assets	**1 464 919**	**110 713**

Long-term receivables and loans issued are recorded at amortised cost. Loss on discounting of long-term receivables is included in finance cost. The amount of the discount as at 31 December 2007 is RUB 117 742 thousand (31 December 2006: RUB 32 802 thousand).

Note 10. Cash and Cash Equivalents

	31 December 2007	31 December 2006
Short-term deposits in RUB (effective interest rate: 7%)	13 851 428	6 171
Cash in bank and in hand in RUB (effective interest rate: 0%)	2 021 546	525 465
Foreign currency accounts (primarily EUR)	103 575	127 582
Total	**15 976 549**	**659 218**

Note 11. Available-for-sale Investments

Bank deposits	Currency	31 December 2007	31 December 2006
OJSC Alfabank (interest rate: 8%)	RUB	4 004 000	-
JSCB Vozrozhdenie Bank (interest rate 0%)	RUB	101 356	-
Total		**4 105 356**	**-**

The bank deposits with Alfabank were placed in October 2007 and their maturity term is May and June 2008.

(in thousands of Russian Roubles, except per share amounts)

Note 12. Accounts Receivable and Prepayments

	31 December 2007	31 December 2006
Trade receivables, net of provision for impairment of RUB 54 760 thousand (31 December 2006: RUB 73 320 thousand)	3 192 192	2 249 758
Other receivables, net of provision for impairment of RUB 30 400 thousand (31 December 2006: RUB 48 124 thousand)	551 480	409 466
Total financial receivables	**3 743 672**	**2 659 224**
Value-added tax receivable	522 961	1 005 897
Advances to suppliers	731 149	76 767
Other taxes receivable	695 841	603 341
Total accounts receivable and prepayments	**5 693 623**	**4 345 229**

Note 13. Inventories

	31 December 2007	31 December 2006
Fuel supplies	1 516 709	1 429 451
Spare parts	483 815	425 149
Raw materials and other supplies	374 722	357 431
Total	**2 375 246**	**2 212 031**

Raw materials and other supplies are recorded net of provision for impairment in the amount of RUB 40 346 thousand (31 December 2006: RUB 42 380 thousand).

Note 14. Equity

14.1 Share capital

	31 December 2007	31 December 2006
Number of ordinary shares authorised, issued and fully paid (thousands)	3 850 959 750	2 902 222 495
Nominal value (in RUB)	0.01	0.01

The share capital of the Company was formed as follows:

- Cash contributions of RUB 10 000 thousand paid in 2006 for the shares in the Company by the founders, namely OJSC Lenenergo (630 000 thousand shares with nominal value of 0.01 RUB), OJSC Karelenergogeneratsya (120 000 thousand shares with nominal value of 0.01 RUB) and OJSC Kolenergo (250 000 thousand shares with nominal value of 0.01 RUB). Shares held by Lenenergo and Kolenergo were subsequently transferred to their successors OJSC Petersburg Generating Company and OJSC Kolskaya Generating Company. On 1 November 2006, after the merger of OJSC Petersburg Generating Company, OJSC Kolskaya Generating Company, OJSC Apatitskaya TPP and OJSC Karelenergogeneratsya into the Company (see also Note 1.1) these shares were classified as treasury shares;
- At 1 November 2006, the Company increased its share capital by RUB 29 012 225 thousand by converting ordinary shares of OJSC Apatitskaya TPP, OJSC Karelenergogeneratsya, OJSC Kolskaya Generating Company and OJSC Petersburg Generating Company into ordinary shares of the Company. As a result, RAO UES shareholdings (49.27% of OJSC Apatitskaya TPP, 100% of OJSC Karelenergogeneratsya, 49.27% of OJSC Kolskaya Generating Company and 56.01% of OJSC Petersburg Generating Company) and minorities' shareholdings (50.73% of OJSC Apatitskaya TPP, 50.73% of OJSC Kolskaya Generating Company and 43.99% of OJSC Petersburg Generating Company) were exchanged for the shares of the Company;

Note 14. Equity (Continued)

- In May 2007, the Company issued 23 022 969 435 ordinary shares for the purposes of share exchange in the shares of OJSC Murmanskaya TPP, entity under control of RAO UES (see also Note 1). Consistent with the previous combinations amongst entities under common control of RAO UES, the Group accounted for the assets and liabilities of Murmanskaya TPP as if it had been the Group's subsidiary from 1 January 2006. Difference between the carrying value of the net assets and the minority interest of the merged subsidiary was included in the Merger reserve of the Group as at that date. As a result of the share issue, Merger reserve decreased by RUB 317 198 thousand for the year ended 31 December 2007.
- In October 2007, the Company issued 925 714 285 713 ordinary shares in exchange for RUB 32 400 000 thousand, net of costs of issuing shares. The share premium in respect of this issue in the amount of RUB 23 142 857 thousand was reflected in equity. As disclosed in Note 1, this share issue was acquired by LLC Russian Energy Projects and Fortum Heat and Power Oy as follows: 680 279 520 000 shares were acquired by LLC Russian Energy Projects and 245 434 765 713 shares were acquired by Fortum. The shareholding structure after the issue is disclosed in Note 1.
- As described in Note 1, on 29 October 2007 the Extraordinary General Meeting of Shareholders of TGC-1 approved additional issue of shares for the purpose of the merger of OJSC "TGC-1 Holding" into the Company. In accordance with the Russian legislation all shareholders of the Company who voted against reorganisation or did not participate in voting on reorganisation could request the Company to buy out all or part of their shares. Consequently, in 2007 the Company purchased its shares from minority shareholders for RUB 20 558 thousand (674 041 000 shares at a price of RUB 0.0305 per share). On the other hand, 1 000 000 000 treasury shares of the Company were distributed among existing shareholders at their nominal value of RUB 0.01 per share.

14.2 Dividends

In accordance with the Russian legislation, the Group distributes profits as dividends or transfers them to reserves (fund accounts) on the basis of financial statements prepared in accordance with Russian Accounting Rules. The statutory accounting reports of the Company are the basis for profit distribution and other appropriations. Russian legislation identifies the basis of distribution as the net profit. For 2007, the current year statutory net profit for the Company as reported in the published annual statutory reporting forms, was RUB 124 122 thousand (2006: RUB 598 158 thousand) and the closing balance of the accumulated losses including the current year statutory net profit totalled RUB 15 864 123 thousand (31 December 2006: RUB 15 599 047 thousand). However, this legislation and other statutory laws and regulations are open to legal interpretation and, accordingly, management believes at present it would not be appropriate to disclose an amount for distributable reserves in these consolidated financial statements.

In 2006, OJSC Apatitskaya TPP declared dividends for the year ended 31 December 2006 of RUB 0.010514 per share totalling RUB 5 000 thousand. Dividends of RUB 2 540 thousand were the share of RAO UES, RUB 2 460 thousand were the share of minority shareholders.

In 2006, OJSC Kolskaya Generating Company declared dividends for the year ended 31 December 2006 of RUB 0.13482 per share totalling RUB 64 121 thousand. Dividends of RUB 32 701 thousand were the share of RAO UES, RUB 31 420 thousand were the share of minority shareholders.

In 2006, OJSC Karelenergogeneratsya declared dividends for the year ended 31 December 2006 of RUB 0.04312944 per share totalling RUB 32 656 thousand, all of which accrued to RAO UES.

In 2006, OJSC Petersburg Generating Company declared dividends for the year ended 31 December 2006 of RUB 0.166042 per share totalling RUB 149 000 thousand. Dividends of RUB 83 447 thousand were the share of RAO UES, RUB 65 553 thousand were the share of minority shareholders.

In May 2007, the Company declared dividends for the first quarter of 2007 of RR 0.00002839307 per share totalling RUB 85 304 thousand.

In June 2007, the Company declared dividends for the year ended 31 December 2006 of RUB 0.000103369 per share totalling RUB 300 000 thousand.

(in thousands of Russian Roubles, except per share amounts)

Note 15. Long-Term Borrowings

	Currency	Effective interest rate	Maturity	31 December 2007	31 December 2006
Long-term bonds	RUB	7.75%	2014	3 849 000	-
NORDIC investment bank	Euro	EURIBOR+3%	2014	1 077 995	1 040 895
European Bank for Reconstruction and Development	Euro	EURIBOR+2.75%	2010	718 664	971 501
				5 645 659	**2 012 396**
Less: current portion					
Long-term bonds				(3 849 000)	-
NORDIC investment bank				(165 845)	-
European Bank for Reconstruction and Development				(287 465)	(276 056)
Total long-term borrowings				**1 343 349**	**1 736 340**

The fair value of long-term borrowings (including the current portion) was estimated by management on the basis of future contracted cash flows and marketable interest rates on similar instruments applicable to the Group as at 31 December 2007.

In March 2007 The Company issued 4 000 000 bonds at a nominal value of RUB 1 000 per bond, with the coupon rate of 7.75%, maturing in 2014.

As disclosed in Note 1, in October 2007 the Extraordinary General Meeting of the Shareholders of the Company made a decision on merging of OJSC “TGC-1 Holding” into the Group. According to the Russian legislation, once the decision on reorganisation is approved by the shareholders, the bond holders can claim their bonds for immediate repayment. Therefore, the long-term bonds issued have been reclassified into current liabilities in these consolidated financial statements. The total amount of bonds actually redeemed in the period November 2007 – April 2008 was RUB 2 988 743 thousand including coupon yield of RUB 136 996 thousand.

Compliance with covenants. In accordance with the long-term borrowings facility agreements, the Group is required to comply with certain financial and non-financial covenants. The most significant and most important covenants are:

- not to sell, transfer, lease, divest or otherwise dispose of certain equipment;
- to maintain certain ratios: EBITDA to Finance Charges, total debt to equity and Current Ratio;
- to maintain certain liquidity and debt-to-assets ratio.

In case of breach of these covenants the schedule of repayment can be changed by the respective lender, up to immediate repayment. Management does not believe that the Group is in danger of breaching the covenants imposed.

The following assets were pledged as collateral under the long-term borrowings:

	31 December 2007	31 December 2006
Property, plant and equipment (net book value)	355 580	573 941
Total	**355 580**	**573 941**

(in thousands of Russian Roubles, except per share amounts)

Note 16. Post-Employment Benefits

The Group operates defined benefit and defined contribution pension plans. In respect of some of these plans the Group has a contract with a pension fund “Non-state pension fund of electrical energy industry” (“NPFE”), which is a separate legal entity; the other plans are operated by the Group without engaging pension funds. Defined contribution plans are considered immaterial for disclosure.

The defined benefit pension plan through NPFE provides for monthly pension benefit paid upon retirement. Annual contributions are made by the Group to the solidarity account in the non-state pension fund. Amount of the contribution is defined by the Group’s budget and is considered to be enough at least to finance running pension benefits. No part of this contribution is recognised as plan asset as far as the Group can recall this money back and the plan is considered as unfunded thereat. Pension benefits are paid from the solidarity account on 'pay-as-go' basis.

Additionally to the NPFE pension plan, the Group provides financial support, of a defined benefit nature, to its old-age pensioners, who have completed certain service for the Group, and other post-employment benefits such as lump-sum payments upon retirement, lump-sum material aid, etc.

The tables below provide information about the benefit obligations, plan assets and actuarial estimations used for the years ended 31 December 2007 and 31 December 2006.

Amounts recognised in the consolidated balance sheet:

	31 December 2007	31 December 2006
Defined benefit obligations	1 016 212	705 224
Unrecognised net actuarial losses	(260 614)	(33 602)
Unrecognised past service cost	(151 577)	(166 014)
Net liability on the balance sheet	**604 021**	**505 608**

Amounts recognised in the consolidated income statement:

	Year ended 31 December 2007	Year ended 31 December 2006
Current service cost	53 416	38 711
Interest cost	47 316	32 732
Past service cost	9 268	630
Actuarial losses on obligation	33 906	-
Total	**143 906**	**72 073**

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

	Year ended 31 December 2007	Year ended 31 December 2006
Benefit obligations		
Benefit obligations as at the beginning of the period	705 224	461 711
Current service cost	53 416	38 711
Interest cost	47 316	32 732
Past service cost	(5 168)	166 644
Benefits paid	(45 494)	(28 176)
Actuarial losses	260 918	33 602
Benefit obligations as at the end of the period	**1 016 212**	**705 224**

The principal actuarial estimations are as follows:

	31 December 2007	31 December 2006
Discount rate for benefits at accumulation phase	6.75%	7.00%
Future salary increase	7.00%	7.00%
Future inflation rate	6.00%	5.00%

(in thousands of Russian Roubles, except per share amounts)

Note 17. Short-Term Borrowings and Current Portion of Long-Term Borrowings

Name of lender	Currency	Effective interest rate	31 December 2007	31 December 2006
OJSC Alfabank	RUB	10-12%	283 300	550 000
OJSC Petroenergobank	RUB	7.0 - 7.5%	250 000	-
OJSC Promstroybank	RUB	8.0-12.5%	-	1 000 000
OJSC Raiffeisen Bank of Austria	RUB	MOSPRIME+3.25%	-	1 000 000
JSCB Promsvyazbank	RUB	8.00%	-	791 148
OJSC Alfabank	RUB	8.9-12.0%	-	590 000
CJSC Citibank	RUB	8.4-8.5%	-	500 000
OJSC Rosbank	RUB	8.5%	-	500 000
CJSC Baltijskiy Bank	RUB	11.0%	-	3 022
Other borrowings from third parties	RUB	3.0%	100 000	-
Current portion of long-term borrowings (Note 15):				
Bonds	RUB		3 849 000	-
European Bank for Reconstruction and Development	Euro	EURIBOR+2.75%	287 465	276 056
NORDIC investment bank		EURIBOR+3%	165 845	-
Total			**4 935 610**	**5 210 226**

Note 18. Accounts Payable and Accrued Liabilities

	31 December 2007	31 December 2006
Trade accounts payable	2 357 816	2 311 781
Accounts payable for capital construction	1 931 205	380 085
Accrued liabilities and other payables	225 670	164 603
Interest accrued on loans	125 525	13 430
Total financial payables	**4 640 216**	**2 869 899**
Advances from customers	1 391 239	1 217 059
Employee benefits	102 786	103 928
Total accounts payable and accrued liabilities	**6 134 241**	**4 190 886**

Note 19. Other Taxes Payable

	31 December 2007	31 December 2006
Property tax	121 686	121 031
Water usage tax	55 806	68 628
Employee taxes	36 409	29 837
Value added tax	11 962	40 392
Other taxes	24 112	32 001
Total	**249 975**	**291 889**

(in thousands of Russian Roubles, except per share amounts)

Note 20. Operating Expenses, net

	Year ended 31 December 2007	Year ended 31 December 2006
Fuel	12 164 266	10 618 498
Employee benefits	4 104 414	3 608 373
Electricity and heat purchases	2 705 590	1 354 069
Depreciation	2 044 821	1 423 943
Water usage expenses	1 504 260	1 550 476
Repairs and maintenance	1 176 047	1 167 179
Heat distribution	985 111	919 514
Taxes other than income tax	865 491	933 050
Other materials	339 605	382 037
Lease expenses	311 938	202 790
Consulting, legal and audit services	282 140	224 205
Security services	281 009	239 146
Transportation services	184 672	52 132
Insurance cost	166 756	117 074
Telecommunication services	84 115	73 423
(Release of)/ provision for impairment of accounts receivable	(28 767)	13 908
Change in financial assets at fair value through profit and loss	94 267	(475 067)
Loss/(gain) on disposal of subsidiaries (Note 21)	44 940	(288 268)
Other operating expenses	1 194 049	1 249 066
Other operating income	(299 759)	(296 592)
Total	**28 204 965**	**23 068 956**

Note 21. Disposal of Subsidiaries

In September 2007 the Group sold 100% of shares of its non-core subsidiary OJSC Karelenergoremont to a third party for a consideration of RUB 61 000 thousand. In 2006 the Group disposed of the shares of its two subsidiaries for a total consideration of RUB 456 132 thousand.

Net assets of the subsidiaries disposed of at the respective dates of sale were as follows:

	Year ended 31 December 2007	Year ended 31 December 2006
Current assets	36 539	197 017
Property, plant and equipment	105 457	122 311
Current liabilities	(21 351)	(145 823)
Non-current liabilities	(14 705)	(3 636)
Net assets	**105 940**	**169 869**
The Group's share in net assets disposed of	(105 940)	(167 864)
Consideration received	61 000	456 132
(Loss)/gain on disposal of subsidiaries	**(44 940)**	**288 268**

Note 22. Finance Cost, net

	Year ended 31 December 2007	Year ended 31 December 2006
Interest expense	574 882	410 501
Interest income	(324 803)	(1 996)
Net finance cost	**250 079**	**408 505**

Note 23. Earnings per Share

	Year ended 31 December 2007	Year ended 31 December 2006
Profit attributable to the shareholders of TGC-1	2 409 513	1 292 752
Weighted average number of ordinary shares issued (thousands)	3 088 279 118	485 694 718
Earnings per ordinary share attributable to the shareholders of TGC-1 – basic and diluted – in Russian Roubles	**0.0008**	**0.0027**

Note 24. Commitments

24.1 Sales commitments

The Group sells electricity in two wholesale market sectors: free trading sector and regulated trading sector. The tariffs for the electricity sold/purchased in the regulated trading sector (including the sector of deviations) are set by the Federal Service on Tariffs.

As at 31 December 2007, the Group entered into a number of annual electricity sales agreements with CJSC Centre for Financial Settlements, CJSC Inter RAO UES, retail companies and large industrial customers. The total amount of electricity sales commitments (net of VAT) was RUB 10 835 558 thousand (31 December 2006: RUB 9 622 477 thousand).

24.2 Fuel commitments

The Group concluded a number of contracts for fuel supply. Main suppliers of gas are CJSC Peterburgregiongaz (subsidiary of OJSC Gazprom, controlled by the State) and OJSC Poiskom; the main supplier of coal is OJSC Plant Polymer. The prices for natural gas and coal stipulated in the contracts are mainly determined on the basis of tariffs established by the FST, published inflation rates and current market prices.

24.3 Contractual capital commitments

As at 31 December 2007, the Group had outstanding contractual commitments in respect of construction of property, and equipment in the amount of RUB 44 126 025 thousand (31 December 2006: none).

Note 25. Contingencies

25.1 Political environment

The operations and earnings of the Group 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.

25.2 Insurance

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

25.3 Legal proceedings

The Group is a party to certain legal proceedings arising in the ordinary course of business. In the opinion of management, there are no current legal proceedings or other claims outstanding and not provided which, upon final disposition, will have a material adverse effect on the financial position of the Group.

25.4 Tax legislation

Russian tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management’s interpretation of such legislation as applied to the transactions and activity of the Group may be challenged by the relevant regional and federal authorities. The Russian tax authorities may be taking a more assertive position in their interpretation of the legislation and assessments, and it is possible that transactions and activities that have not been challenged in the past may be challenged. In October 2006, the Supreme Arbitration Court issued guidance to lower courts on reviewing tax cases providing a systemic roadmap for anti-avoidance claims, and it is possible that this will significantly increase the level and frequency of tax authorities scrutiny. As a result, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

As at 31 December 2007 and 2006 management believes that its interpretation of the relevant legislation is appropriate and the Group’s tax and currency positions will be sustained. Accordingly, no provision for potential tax liabilities has been recorded. The Group estimates that it has potential obligations from exposure to other than remote tax risks related to pricing and documentation of certain transactions, of RUB 756 800 thousand (31 December 2006: RUB 480 500 thousand).

(in thousands of Russian Roubles, except per share amounts)

Note 25. Contingencies (Continued)

In addition, tax and other legislation do not address specifically all the aspects of the Group's reorganization related to reforming of the electric utilities industry. As such there may be tax and legal challenges to the various interpretations, transactions and resolutions that were a part of the reorganisation and reform process.

25.5.Environmental matters

The enforcement of environmental regulation in the Russian Federation is evolving and the enforcement posture of government authorities is continually being reconsidered. The Group periodically evaluates its 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.

25.6 Compliance with covenants

The Group is subject to certain covenants related to its long-term borrowings (see Note 15). Non-compliance with such covenants may result in negative consequences for the Group including growth in the cost of borrowings and declaration of default. The Group's management believes that the Group is in compliance with covenants.

Note 26. Financial Risk Management

26.1 Financial risks

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 formal risk policy to hedge its financial exposures.

26.2 Credit risk

Financial assets, which potentially subject the Group 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 provision for impairment of receivables already recorded.

Cash transactions are conducted through high-credit-quality financial institutions. Cash is placed in financial institutions, which are considered at time of deposit to have minimal risk of default.

The table below shows the rating and balances with major banks at the balance sheet dates:

	Rating agency	National scale ratings	Note	Long-term RDE* in foreign currency	31 December 2007	31 December 2006
Cash at bank						
SEB Bank	-	-		-	227 159	373 534
Bank St.Petersburg	Fitch	-		B+	121 988	4
Sberbank	Fitch			BBB+	7 265 214	4 320
NB Trust	Fitch	-		B-	128 913	20 052
Alfabank	Fitch	AA-(rus)		BB	2 006 570	571
VTB	Fitch	AAA(rus)		BBB+	5 439 025	37 316
Bank Rossiya	Fitch	BB-(rus)		B-	643 091	-
Other	-	-		-	144 589	223 421
Total			10		**15 976 549**	**659 218**
Bank deposits						
Alfabank	Fitch	AA-(rus)		BB	4 004 000	-
Vozrozhdeniye	-	-		-	101 356	-
Total			11		**4 105 356**	**-**

** Rating of the default of the emitter*

(in thousands of Russian Roubles, except per share amounts)

Note 26. Financial Risk Management (Continued)

At the balance sheet date there were no significant concentrations of credit risk. The maximum exposure to credit risk at the reporting date without taking account of any collateral held is as follows:

	31 December 2007	31 December 2006
Cash and cash equivalents (Note 10)	15 976 549	659 218
Available-for-sale investments (Note 11)	4 105 356	-
Total financial receivables (Note 12)	3 743 672	2 659 224
Other non-current assets (Note 9)	193 949	110 713
Total	**24 019 526**	**3 429 155**

Total financial receivables by type of customers are presented in the table below:

	31 December 2007	31 December 2006
End-user customers	2 758 430	1 875 860
Wholesale customers	457 718	470 678
RAO UES Group	341 945	167 483
Free market	175 642	107 582
Export	9 937	37 621
Total	**3 743 672**	**2 659 224**

Total financial receivables on a contract basis as at the reporting date are presented in the table below:

	Fully performing	Overdue	Impaire
Total financial receivables as at 31 December 2007	2 807 289	936 383	85 1
Total financial receivables as at 31 December 2006	2 117 267	541 957	121 4

Fully performing trade receivables relate to a number of independent customers for whom there is no recent history of default. The majority of performing trade receivables are represented by large number of individually insignificant end-user customers, therefore the credit risk is widely spread.

The overdue financial receivables have the following ageing structure:

	31 December 2007	31 December 2006
Up to 45 days	408 520	300 213
From 45 to 90 days	177 014	117 074
More than 90 days	350 849	124 670
Total	**936 383**	**541 957**

Movements in impairment provision for financial receivables are as follows:

	Year ended 31 December 2007	Year ended 31 December 2006
Provision for impairment as at 1 January	**121 444**	**145 548**
Impairment loss recognised during the period	2 885	38 855
Impairment loss reversed during the period	(31 652)	(24 947)
Used during the period	(7 517)	(38 012)
Provision for impairment as at 31 December	**85 160**	**121 444**

(in thousands of Russian Roubles, except per share amounts)

Note 26. Financial Risk Management (Continued)

26.3 Currency risk

The Group takes on exposure to effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The table below summarises the Group's exposure to foreign currency exchange rate risk as at 31 December 2007. Included in the table are the Group's financial assets and liabilities at carrying amounts, categorised by currency.

	RUB	USD	EUR	Total
Assets				
Cash in bank	15 872 974	8 850	94 725	15 976 549
Available-for-sale investments	4 105 356	-	-	4 105 356
Total financial receivables	3 743 672	-	-	3 743 672
Other non-current assets	193 949	-	-	193 949
Total financial assets	**23 915 951**	**8 850**	**94 725**	**24 019 526**
Liabilities				
Long-term borrowings	-	-	(1 343 349)	(1 343 349)
Short-term borrowings	(4 482 300)	-	(453 310)	(4 935 610)
Total other financial liabilities	(4 640 216)	-	-	(4 640 216)
Total financial liabilities	**(9 122 516)**	**-**	**(1 796 659)**	**(10 919 175)**
Net balance sheet position	**14 793 435**	**8 850**	**(1 701 934)**	**13 100 351**

As at 31 December 2006, the Group had the following currency positions:

	RUB	USD	EUR	Total
Assets				
Cash in bank	531 636	20	127 562	659 218
Other non-current assets	110 713	-	-	110 713
Total financial receivables	2 659 224	-	-	2 659 224
Total financial assets	**3 301 573**	**20**	**127 562**	**3 429 155**
Liabilities				
Long-term borrowings	-	-	(1 736 340)	(1 736 340)
Short-term borrowings	(4 934 170)	-	(276 056)	(5 210 226)
Total other financial liabilities	(2 869 895)	-	-	(2 869 895)
Total financial liabilities	**(7 804 065)**	**-**	**(2 012 396)**	**(9 816 461)**
Net balance sheet position	**(4 502 492)**	**20**	**(1 884 834)**	**(6 387 306)**

26.4 Liquidity risk

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group's liquidity risk management includes maintaining sufficient cash to fund operations and the investment programme and the availability of funding from an adequate amount of committed credit facilities.

(in thousands of Russian Roubles, except per share amounts)

Note 26. Financial Risk Management (Continued)

The table below analyses the Group's financial liabilities into relevant maturity groupings based on the remaining period at the balance sheet to the contractual maturity date, based on the contractual undiscounted amounts, including future interest payments.

As at 31 December 2007

	Carrying amount	Contractual cash flows	Within 6 months	6-12 months	1-2 years	2-5 years
Borrowings	6 278 959	6 829 176	4 545 322	693 534	918 948	671 372
Total other financial liabilities	4 640 216	4 640 216	4 640 216	-	-	-
Total	**10 919 175**	**11 469 392**	**9 185 538**	**693 534**	**918 948**	**671 372**

As at 31 December 2006

	Carrying amount	Contractual cash flows	Within 6 months	6-12 months	1-2 years	2-5 years
Borrowings	6 946 566	7 522 541	3 671 001	1 786 495	1 072 864	992 181
Total other financial liabilities	2 869 895	2 869 895	2 869 895	-	-	-
Total	**9 816 461**	**10 392 436**	**6 540 896**	**1 786 495**	**1 072 864**	**992 181**

As at 31 December 2007, the contractual cash flows for financial liabilities were translated using the following rates: CB RF official exchange rates as at 31 December 2007 of EUR 1 = RUB 35.9332 (31 December 2006: EUR 1 = RUB 34.6965) and future interest was calculated using EURIBOR effective rate as at 31 December 2007 of 4.745% (31 December 2006: 4.028%).

26.5 Market risk

The Group also operates internationally and is exposed to foreign exchange risk arising from various currency exposures, primarily with respect to the Euro. Foreign exchange risk arises on foreign currency denominated borrowings (see Note 15 and Note 17). The Group does not have formal arrangements to mitigate this risk.

At 31 December 2007, if the Russian Rouble had weakened/strengthened by 10% against the EUR with all other variables held constant, the post-tax profit for the year would have been RUB 170 192 thousand (2006: RUB 188 468 thousand) lower/higher. Since the Group does not hold any financial instruments revalued through equity, the effect of change of exchange rate on equity would be the same as on post-tax profit.

26.6 Interest rate risk

The Group's operating profits and cash flows from operating activity are largely independent of changes in market interest rates. The Group's interest rate risk arises from long-term borrowings. Borrowings issued at variable rates expose the Group to cash flow interest rate risk. Borrowings issued at fixed rates expose the Group to fair value interest rate risk.

At the reporting date the interest rate profile of the Group's interest-bearing financial instruments was:

	Carrying amount	
	31 December 2007	**31 December 2006**
Fixed rate instruments		
Short-term loans and borrowings	4 482 300	4 210 226
Variable rate instruments		
Long-term loans and borrowings	1 343 349	1 736 340
Short-term loans and borrowings	453 310	1 000 000
Total	**6 278 959**	**6 946 566**

The Group analyses its interest rate exposure on a regular basis. Various scenarios are simulated taking into consideration refinancing, renewal of existing positions and alternative financing. Based on these scenarios, the Group calculates the impact on profit and loss of a defined interest rate shift.

A general increase/decrease of one percent in interest rates would have decreased/increased the Group's profit after income tax for the year ended 31 December 2007 by approximately RUB 1 347 thousand. The effect on equity (retained earnings) would be the same as on post-tax profit.

(in thousands of Russian Roubles, except per share amounts)

Note 26. Financial Risk Management (Continued)

26.7 Fair value sensitivity analysis for fixed rate instruments

In 2007 the Group did not hold any fixed rate financial assets and liabilities at fair value through profit or loss, and the Group did not designate derivatives as hedging instruments under a fair value hedge accounting model. Therefore a change in interest rate at the reporting date would not affect profit or loss.

Should the market value of 1 equity share in OJSC Power Machines be increased/decreased by 6% then an estimate of the fair value of such shares held by the Group would result in a increase/decrease of RUB 53 414/ (53 414) thousand as at 31 December 2006. The effect on equity (retained earnings) would be the same as on post-tax profit.

26.8 Fair values

Management believes that the fair values of the Group's financial assets and liabilities approximate their carrying values.

26.9 Capital risk management

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns to equity holders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital.

In order to maintain or adjust the capital structure, the Group may adjust the amount of dividends paid to equity holders, return capital to equity holders or issue new shares.

The Group monitors capital on the basis of the gearing ratio to be consistent with other companies in the industry. This ratio is calculated as net debt divided by total capital. Net debt is calculated as total borrowings (including borrowings and trade and other payables, as shown in the consolidated balance sheet) less cash and cash equivalents. Total capital is calculated as equity, as shown in the consolidated balance sheet, plus net debt. Management of capital is linked to maintaining certain financial ratios to comply with covenants imposed by the banks (see Note 15).

During 2007, the Group's strategy, which was unchanged from 2006, was to maintain a gearing ratio between net debt and equity not higher than 0.6. The gearing ratios at 31 December 2007 and 31 December 2006 were as follows:

	31 December 2007	31 December 20
Total borrowings	6 278 959	6 946 5
Trade and other liabilities	6 146 573	4 190 8
Less: cash and cash equivalents	(15 976 549)	(659 2
Net debt	(3 551 017)	10 478 2
Total equity	58 581 977	24 894 6
Total capital	**55 030 960**	**35 372 8**
Debt % in Capital Structure	(6.45%)	29.62
Equity % in Capital Structure	106.45%	70.38
Gearing ratio	(0.06)	0.

The significant decrease in the gearing ratio during 2007 resulted primary from the issuance of share capital (see Note 14).

Note 27. Subsequent Events

On 20 February 2008, the Company, Fortum Heat and Power Oy and ECF Project Limited signed an Agreement according to which Fortum will purchase approximately 5 million tonnes of carbon dioxide (CO2) emission reduction units (ERU) from the Company. This Agreement will be effective from 1 January 2008 to 31 December 2012 subject to approval by the Governments of Finland and Russian Federation. The Group estimates its revenue if this Agreement is enacted as approximately RUB 1 300 000 thousand for the term of the Agreement.

As disclosed in Notes 1 and 14, in October 2007, the Extraordinary General Meeting of the Shareholders of the Company made a decision on merging of OJSC “TGC-1 Holding” into the Group. According to the Russian legislation, once the decision on reorganisation is approved by the shareholders, the bond holders can claim their bonds for immediate repayment. Therefore, the long-term bonds issued have been reclassified into the current liabilities in these consolidated financial statements. The total amount of bonds actually redeemed in the period November 2007 – April 2008 was RUB 2 988 743 thousand including coupon yield of RUB 136 996 thousand.

On 4 March 2008, the Board of Directors of the Company approved additional private issue of 3 671 800 907 ordinary shares with par value of RUB 0.01 each for the purpose of further converting them into ordinary shares of OJSC “TGC-1 Holding” and of 384 359 559 ordinary shares with value of RUB 0.01 each for the purpose of further converting them into the preference shares of OJSC “TGC-1 Holding”. The above additional issue was registered 18 April 2008. See also Note 1 for the details of the approved reorganisation of the Company.