

**OGK-2 GROUP  
COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS  
PREPARED IN ACCORDANCE WITH  
INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)  
FOR THE YEARS ENDED 31 DECEMBER 2006 AND 31 DECEMBER 2005**

## INDEPENDENT AUDITOR'S REPORT

### To the Shareholders and the Board of Directors of Open Joint Stock Company "The Second Generating Company of the Wholesale Electric Power Market" (OJSC OGK-2):

We have audited the accompanying combined and consolidated financial statements of OJSC OGK-2 and its subsidiaries (the "OGK-2 Group") which comprise the combined and consolidated balance sheets as at 31 December 2006 and 31 December 2005 and the combined and consolidated statements of operations, combined and consolidated statements of changes in equity and combined and consolidated statements of cash flows for the two years then ended and a summary of significant accounting policies and other explanatory notes.

#### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these combined and 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 combined and 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 combined and consolidated financial statements present fairly, in all material respects, the financial position of the OGK-2 Group as at 31 December 2006 and 31 December 2005, and its financial performance and its cash flows for the two years then ended in accordance with International Financial Reporting Standards.

INDEPENDENT AUDITOR'S REPORT

*Emphasis of Matter*

Without qualifying our opinion, we draw attention to Note 3 of the accompanying combined and consolidated financial statements. These combined and consolidated financial statements include carved out revenues and expenses related to periods from 1 January 2005 to 1 April 2005 and 1 July 2005 of electricity and heat generating divisions within OJSC Sverdlovenenergo and OJSC Tyumenenergo respectively, predecessor legal entities that had other business activities. Because of the various determinations used in carving out such revenues and expenses, as described in Note 3 and elsewhere in these combined and consolidated financial statements, those revenues and expenses related to the electricity and heat generation operations within predecessor legal entities may not be indicative of revenues expected to be earned and costs expected to be incurred on a prospective basis for the electricity and heat generation operations within the OGK-2 Group as a separate business and, as such, these combined and consolidated financial statements may not be indicative of future results of operations and trends.

Without qualifying our opinion, we draw attention to Notes 1, 2 and 5 to the accompanying combined and consolidated financial statements. The Government of the Russian Federation has an ultimate controlling interest in the OGK-2 Group and Governmental economic and social policies affect the Group's financial position, results of operations and cash flows.

*ZAO PricewaterhouseCoopers*

Moscow, Russian Federation  
30 June 2007

**OGK-2 Group**  
**Combined and Consolidated Balance Sheet as at 31 December 2006 and 31 December 2005**  
(in thousands of Russian Roubles)

|  | Notes | 31 December 2006  | 31 December 2005  |
|--|-------|-------------------|-------------------|
| <b>ASSETS</b>  |       |                   |                   |
| <b>Non-current assets</b>                            |       |                   |                   |
| Property, plant and equipment                        | 6     | 17,346,025        | 13,199,750        |
| Intangible assets                                    | 7     | 298,861           | 88,832            |
| Other non-current assets                             | 8     | 211,842           | 171,016           |
| <b>Total non-current assets</b>                      |       | <b>17,856,728</b> | <b>13,459,598</b> |
| <b>Current assets</b>                                |       |                   |                   |
| Cash   |       | 1,178,570         | 880,355           |
| Accounts receivable and prepayments                  | 9     | 1,917,403         | 1,896,167         |
| Inventories  | 10    | 1,980,743         | 1,192,543         |
| Current income tax prepayments                       |       | 241,477           | 69,682            |
| Other current assets                                 | 11    | 541,709           | 4,037             |
| <b>Total current assets</b>                          |       | <b>5,859,902</b>  | <b>4,042,784</b>  |
| <b>TOTAL ASSETS</b>                                  |       | <b>23,716,630</b> | <b>17,502,382</b> |
| <b>EQUITY AND LIABILITIES</b>                        |       |                   |                   |
| <b>Equity</b>  |       |                   |                   |
| Share capital  |       |                   |                   |
| Ordinary shares (nominal value RR 26,480,896)        | 12    | 26,480,896        | 10,769,804        |
| Share premium  |       | 1,818,408         | -                 |
| Merger reserve                                       |       | (17,508,697)      | (2,146,523)       |
| Retained earnings                                    |       | 2,284,262         | 296,614           |
| Minority interest                                    |       | -                 | 2,306,639         |
| <b>Total equity</b>                                  |       | <b>13,074,869</b> | <b>11,226,534</b> |
| <b>Non-current liabilities</b>                       |       |                   |                   |
| Deferred tax liabilities                             | 13    | 2,700,229         | 1,836,395         |
| Non-current debt                                     | 14    | 1,074,660         | 501,937           |
| Pension liabilities                                  | 18    | 371,119           | 311,053           |
| <b>Total non-current liabilities</b>                 |       | <b>4,146,008</b>  | <b>2,649,385</b>  |
| <b>Current liabilities</b>                           |       |                   |                   |
| Current debt and current portion of non-current debt | 15    | 4,662,797         | 1,030,771         |
| Accounts payable and accruals                        | 16    | 1,481,092         | 1,740,137         |
| Current income tax liabilities                       |       | 2                 | 133,597           |
| Other taxes payable                                  | 17    | 351,862           | 721,958           |
| <b>Total current liabilities</b>                     |       | <b>6,495,753</b>  | <b>3,626,463</b>  |
| <b>Total liabilities</b>                             |       | <b>10,641,761</b> | <b>6,275,848</b>  |
| <b>TOTAL EQUITY AND LIABILITIES</b>                  |       | <b>23,716,630</b> | <b>17,502,382</b> |

General Director

M.V.Kuzichev

Chief Accountant

A.P.Vainilavichute

30 June 2007



**OGK-2 Group****Combined and Consolidated Income Statement for the years ended 31 December 2006 and 31 December 2005**

(in thousands of Russian Roubles, except for earning/(loss) per ordinary share information)

|   | Notes     | Year ended<br>31 December 2006 | Year ended<br>31 December 2005 |
|---|-----------|--------------------------------|--------------------------------|
| Revenues  | 19        | 25,433,668                     | 19,396,553                     |
| Operating expenses (excluding reversal of impairment of property, plant and equipment)  | 21        | (26,181,705)                   | (19,427,128)                   |
| Reversal of impairment of property, plant and equipment, net  | 6         | 4,307,159                      | 1,140,481                      |
| Operating expenses  |           | (21,874,546)                   | (18,286,647)                   |
| Other operating income  | 20        | 97,827                         | 229,077                        |
| <b>Operating profit</b>   |           | <b>3,656,949</b>               | <b>1,338,983</b>               |
| Finance costs   | 22        | (267,558)                      | (186,395)                      |
| <b>Profit before income tax</b>   |           | <b>3,389,391</b>               | <b>1,152,588</b>               |
| Total income tax charge   | 13        | (955,378)                      | (598,342)                      |
| <b>Profit for the year</b>  |           | <b>2,434,013</b>               | <b>554,246</b>                 |
| Attributable to:  |           |                                |                                |
| Shareholders of OJSC OGK-2  |           | 2,566,548                      | 420,325                        |
| Minority interest   |           | (132,535)                      | 133,921                        |
| <b>Earnings per ordinary share for profit attributable to the shareholders of OJSC OGK-2 – basic and diluted (in Russian Roubles)</b> | <b>23</b> | <b>0.097</b>                   | <b>0.02</b>                    |

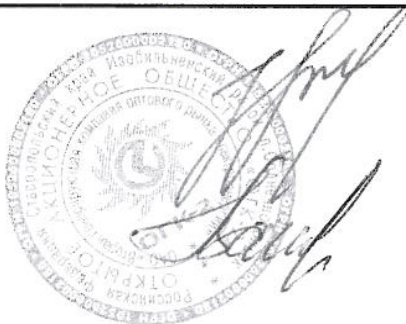
General Director

M.V.Kuzichev

Chief Accountant

A.P.Vainilavichute

30 June 2007



**OGK-2 Group**  
**Combined and Consolidated Cash Flow Statement for the years ended 31 December 2006 and**  
**31 December 2005**

(in thousands of Russian Roubles)

|   | Notes | Year ended<br>31 December 2006 | Year ended<br>31 December 2005 |
|---|-------|--------------------------------|--------------------------------|
| <b>CASH FLOW FROM OPERATING ACTIVITIES:</b>   |       |                                |                                |
| Profit before income tax  |       | 3,389,391                      | 1,152,588                      |
| Adjustments to reconcile profit before income tax to net cash provided by operations: |       |                                |                                |
| Depreciation of property, plant and equipment   | 6     | 855,823                        | 856,310                        |
| Reversal of impairment of property, plant and equipment                               | 6     | (4,307,159)                    | (1,140,481)                    |
| Charge / (reversal) of provision for impairment of accounts receivable                |       | 196,303                        | (74,735)                       |
| (Decrease)/ Increase of provision for inventory obsolescence                          |       | (51,589)                       | 10,764                         |
| Interest expense  |       | 222,464                        | 148,397                        |
| Prior period taxes reversed   |       | (212,971)                      | (179,176)                      |
| Forgiveness of tax penalties  |       | -                              | (197,243)                      |
| Accrual for pension liabilities   |       | 60,066                         | 29,734                         |
| Loss on disposal of fixed assets  |       | 179,887                        | 30,508                         |
| Other non-cash items  |       | 82,019                         | 59,005                         |
| <b>Operating cash flows before working capital changes and income tax paid</b>        |       | <b>414,234</b>                 | <b>695,671</b>                 |
| Working capital changes:  |       |                                |                                |
| Increase in accounts receivable and prepayments                                       |       | (231,015)                      | (155,757)                      |
| (Increase)/Decrease in inventories  |       | (736,611)                      | 76,253                         |
| (Increase)/Decrease in other current assets   |       | (37,672)                       | 36,741                         |
| Decrease in other non-current assets  |       | (40,826)                       | (105,693)                      |
| (Decrease)/Increase in accounts payable and accruals                                  |       | (164,081)                      | 489,613                        |
| (Decrease)/Increase in taxes payable, other than income tax                           |       | (398,256)                      | 521,587                        |
| Increase in other non-current liabilities   |       | -                              | (69,532)                       |
| Income tax paid in cash   |       | (237,210)                      | (270,818)                      |
| <b>Net cash (used in)/provided from operating activities</b>                          |       | <b>(1,431,437)</b>             | <b>1,218,065</b>               |
| <b>CASH FLOW FROM INVESTING ACTIVITIES:</b>   |       |                                |                                |
| Purchase of property, plant and equipment and other non-current assets                |       | (826,400)                      | (501,686)                      |
| Proceeds from sale of property, plant and equipment and other non-current assets      |       | 22,248                         | -                              |
| Acquisitions of intangible assets   |       | (210,029)                      | (88,832)                       |
| Purchase of short-term investments  |       | (500,000)                      | -                              |
| <b>Net cash used in investing activities</b>  |       | <b>(1,514,181)</b>             | <b>(590,518)</b>               |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>  |       |                                |                                |
| Proceeds from short-term borrowings   |       | 12,464,375                     | 3,999,259                      |
| Proceeds from long-term borrowings  |       | 1,401,000                      | 365,000                        |
| Repayment of short-term debt  |       | (8,832,228)                    | (3,991,681)                    |
| Repayment of long-term debt   |       | (766,000)                      | -                              |
| Interest paid   |       | (205,378)                      | (127,563)                      |
| Payments under finance lease  |       | (133,900)                      | (96,830)                       |
| Dividend paid by the Group to shareholders of OGK-2                                   |       | (606,217)                      | (3,755)                        |
| Dividend paid by the Group to minority interest shareholders                          |       | (77,819)                       | (66,976)                       |
| Cash contribution to share capital  |       | -                              | 21,075                         |
| <b>Net cash provided from financing activities</b>                                    |       | <b>3,243,833</b>               | <b>98,529</b>                  |
| <b>Net increase in cash</b>   |       | <b>298,215</b>                 | <b>726,074</b>                 |
| <b>Cash at the beginning of the year</b>  |       | <b>880,355</b>                 | <b>154,281</b>                 |
| <b>Cash at the end of the year</b>  |       | <b>1,178,570</b>               | <b>880,355</b>                 |

General Director

M.V.Kuzichev

Chief Accountant

A.P.Vainilavichute

30 June 2007



*(Handwritten signatures)*

**OGK-2 Group**  
**Combined and Consolidated Statement of Changes in Equity for the years ended 31 December 2006 and 31 December 2005**  
(in thousands of Russian Roubles)

Attributable to the shareholders of JSC OGK-2

|                                    | Ordinary share capital | Share premium    | Merger reserve      | Retained earnings | Total             | Minority interest | Total Equity      |
|------------------------------------|------------------------|------------------|---------------------|-------------------|-------------------|-------------------|-------------------|
| <b>At 1 January 2005</b>           | -                      | -                | 8,602,206           | -                 | 8,602,206         | 2,288,294         | 10,890,500        |
| Profit for the year                | -                      | -                | -                   | 420,325           | 420,325           | 133,921           | 554,246           |
| Payment of share capital (Note 12) | 10,769,804             | -                | (10,748,729)        | -                 | 21,075            | -                 | 21,075            |
| Change in Group's structure        | -                      | -                | -                   | (1,783)           | (1,783)           | (976)             | (2,759)           |
| Dividends (Note 12)                | -                      | -                | -                   | (121,928)         | (121,928)         | (114,600)         | (236,528)         |
| <b>At 31 December 2005</b>         | <b>10,769,804</b>      | <b>-</b>         | <b>(2,146,523)</b>  | <b>296,614</b>    | <b>8,919,895</b>  | <b>2,306,639</b>  | <b>11,226,534</b> |
| Profit/(loss) for the year         | -                      | -                | -                   | 2,566,548         | 2,566,548         | (132,535)         | 2,434,013         |
| Dividends (Note 12)                | -                      | -                | -                   | (578,900)         | (578,900)         | (6,778)           | (585,678)         |
| Payment of share capital (Note 12) | 15,711,092             | 1,818,408        | (15,362,174)        | -                 | 2,167,326         | (2,167,326)       | -                 |
| <b>At 31 December 2006</b>         | <b>26,480,896</b>      | <b>1,818,408</b> | <b>(17,508,697)</b> | <b>2,284,262</b>  | <b>13,074,869</b> | <b>-</b>          | <b>13,074,869</b> |

General Director

M.V.Kuzichev

Chief Accountant

A.P.Vainilavichute



30 June 2007

**Note 1. The Group and its operations**

Open Joint-Stock Company "The Second Generating Company of the Wholesale Electric Power Market" (JSC "OGK-2", or the "Company") was established on 9 March 2005 within the framework of Russian electricity sector restructuring in accordance with the Resolution No. 1254-r adopted by the Russian Federation Government on 1 September 2003.

The OGK-2 Group's (the "Group") primary activities are generation and sale of electric and heat power. The Group primarily consists of the following power stations: Troitskaya GRES, Stavropolskaya GRES, Pskovskaya GRES, Serovskaya GRES and Surgutskaya GRES-1 (see also *Establishment of the Group* below).

The Company is registered by the Izobilnensk District Inspectorate of the RF Ministry of Taxation of Stavropol Region.

The Company's office is located at 56, Profsoyuznaya str., 117393, Moscow, Russia.

**Operating environment.** Whilst there have been improvements in economic trends in the Russian Federation, the country continues to display certain 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. Furthermore, the tax, currency and customs legislation within the Russian Federation is subject to varying interpretations and changes, which can occur frequently.

**Relations with the state and current regulation.** As at 31 December 2006 the Russian Federation owned 52.7% of the Russian Open Joint Stock Company for Energy and Electrification Unified Energy System of Russia ("RAO UES") (the "Parent"), which in its turn owned 80.93% of voting ordinary shares of JSC OGK-2 (100% as at 31 December 2005). The Russian government is the ultimate controlling party of the Company.

The Group's customer base includes a large number of entities controlled by or related to the state. Moreover, the state controls a number of the Group's fuel suppliers.

The Government of the Russian Federation directly affects the Group's operations through regulation by the Federal Tariff Service ("FTS"), with respect to its wholesale energy sales, and by the Regional Tariff Services ("RTSs"), with respect to its heat sales. The operations of all generating facilities are coordinated by JSC System Operator – Central Despatch Unit of Unified Energy System ("SO-CDU") in order to meet system requirements in an efficient manner. 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 ("RAR"), a basis of accounting which significantly differs from International Financial Reporting Standards ("IFRS"). In practice, tariff decisions were impacted significantly by social and political considerations, causing significant delays in tariff determinations and tariff increases that were lower than required to compensate for cost increases.

As described in Notes 2, 24 and 25, the Government's economic, social and other policies could have material effects on the operations of the Group.

**Regulatory issues and sector restructuring.** The Russian electric utilities industry is presently undergoing a reform process designed to introduce competition into the electricity sector and to create an environment in which the RAO UES Group and its successor companies (including JSC "OGK-2") can raise the 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 August 31, 2006 and which came into force on September 1, 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.

From 2007 the volumes of electricity (power) traded in the wholesale market at regulated prices will begin to be substantially reduced. The pace of reduction was set by the Russian Federation Government according to socio-economic development forecasts. In 2007 it is expected up to 90% of the forecasted production volumes will be 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 develop.

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

### ***Establishment of the Group***

The Company was incorporated on 9 March 2005 by its then sole shareholder RAO UES. At the date of incorporation, RAO UES made contributions to the Company's charter capital in the form of shares of the thermal power generating companies OJSC "Troitskaya GRES" ("**OJSC Troitskaya GRES**"), OJSC "Stavropolskaya GRES" ("**OJSC Stavropolskaya GRES**") and OJSC "Pskovskaya GRES" ("**OJSC Pskovskaya GRES**"). These three generating companies had been incorporated as subsidiaries of RAO UES in 1993 (OJSC Troitskaya GRES and OJSC Stavropolskaya GRES) and 1994 (OJSC Pskovskaya GRES), and, following their contribution to the Company in March 2005, became operating subsidiaries of the Company.

On 22 May 2006, the Company acquired control through a transfer of business under common control of a further two generating companies, OJSC "Serovskaya GRES" ("**OJSC Serovskaya GRES**") and OJSC "Surgutskaya GRES-1" ("**OJSC Surgutskaya GRES-1**"). In contrast to the three generating companies referred to above, neither of these two subsidiaries had existed as a separate business unit prior to 2005. OJSC Serovskaya GRES had been incorporated on 1 April 2005 and comprised various business and production assets that had been transferred from JSC "Sverdlovenenergo" ("**JSC Sverdlovenenergo**"), a subsidiary of RAO UES. OJSC Surgutskaya GRES-1 had been incorporated on 1 July 2005 and comprised various business and production assets that had been transferred from another subsidiary of RAO UES, JSC "Tyumenenergo" ("**JSC Tyumenenergo**"). Each of JSC Sverdlovenenergo and JSC Tyumenenergo had comprised various businesses in addition to electric and heat energy generation, and the assets that were transferred to OJSC Serovskaya GRES and OJSC Surgutskaya GRES-1, respectively, had not in either case been operated as an identifiable and discrete business unit.

On 29 September 2006, each of OJSC Troitskaya GRES, OJSC Stavropolskaya GRES, OJSC Pskovskaya GRES, OJSC Serovskaya GRES and OJSC Surgutskaya GRES-1 were merged with the Company. As a result, they ceased to exist as separate legal entities and became operating units of the Company.

See also Note 12 for further details.

After the merger the Company doesn't have any other material subsidiaries.

### **Note 2. Financial condition**

As at 31 December 2006, the Group's current liabilities exceeded its current assets by Russian Roubles ("RR") 635,851 thousand (as at 31 December 2005 the Group's current assets exceeded its current liabilities by RR 416,321 thousand).

As discussed above the Group is affected by government policy through the control of tariffs and other factors. The FTS does not always permit tariff increases in line with increases in the Group's costs and

## OGK-2 Group

### Notes to the Combined and Consolidated Financial Statements for the years ended 31 December 2006 and 31 December 2005

(in thousands of Russian Roubles)

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thus some tariffs are insufficient to cover all the costs of generation. Moreover, these tariffs consider costs only on a Russian statutory basis and, accordingly, exclude additional costs recognized under an IFRS basis of accounting. As a result, tariffs may not consistently allow for an adequate return on investment and currently do not provide sufficient funds for the full replacement of property, plant and equipment. However, during 2006 and to date in 2007 the growing demand for electricity and capacity together with increasing the free trading sector of the wholesale electricity market have resulted in a higher rate of revenue growth (see Regulatory issues and sector restructuring in Note 1).

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

- introduction of improved financial budgeting procedures, a strong focus on timely cash collection of current and old debtor balances;
- discussions with strategic investors, and identification and assessment of projects requiring investment funds;
- negotiations with federal and regional governments and regulators for real increases in tariffs to support adequate long term investment into the Group's generation, transmission and distribution assets;
- raising long-term debt/equity financing for investments in new generation assets.

#### Note 3. Basis of preparation

**Statement of compliance.** These combined and consolidated financial statements ("Financial Statements") have been prepared in accordance with International Financial Reporting Standards ("IFRS") and related interpretations adopted by the International Accounting Standards Board ("IASB").

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

**Functional and presentation currency.** The national currency of the Russian Federation is the Russian rouble ("RR"), which is the functional currency of each of the Group's entities and the currency in which these financial statements are presented. All financial information presented in RR has been rounded to the nearest thousand.

**Predecessor Accounting.** During 2005, the Parent transferred to the Company 100% less 1 share, 51.01% and 50.00% of the outstanding ordinary shares of Troitskaya GRES, Stavropolskaya GRES and Pskovskaya GRES respectively. During 2006 the Parent transferred to the Company 100% and 65.33% of the outstanding ordinary shares of Surgutskaya GRES-1 and Serovskaya GRES respectively in exchange for the ordinary shares of the Company.

In these combined and consolidated financial statements, the Group accounted for the business combination with these entities as business combinations amongst entities under common control under an accounting policy using the predecessor values method. Accordingly, assets and liabilities of the contributed entities were accounted for at the carrying value, as determined by RAO UES in its IFRS consolidated financial statements. Information in respect of the comparative period and opening balances as at 1 January 2005 has been restated as if the business combination took place at the beginning of the earliest period presented. Therefore Troitskaya GRES, Stavropolskaya GRES, Pskovskaya GRES, Serovskaya GRES and Surgutskaya GRES-1 were accounted in the Group's combined and consolidated financial statements effective from 1 January 2005.

The difference between the consideration paid and the predecessor carrying values of the net assets relating to the acquisition of a business from an entity under common control is recorded in equity, as a merger reserve.

**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"). IAS 29 requires that the financial statements prepared in the currency of a hyperinflationary economy be stated in terms of the measuring unit current at the balance sheet date. 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 of these financial statements.

**New accounting developments.** Certain new IFRSs became effective for the Group from 1 January 2006. 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.

- IAS 39 (Amendment) – The Fair Value Option;
- IFRIC 4, Determining whether an Arrangement contains a Lease;
- IAS 39 (Amendment) – Cash Flows Hedge Accounting of Forecast Intragroup Transactions;
- IAS 39 (Amendment) – Financial Guarantee Contracts;
- IAS 21 (Amendment) – Net Investment in a Foreign Operation;
- IAS 19 (Amendment) – Employee Benefits;
- IFRIC 5, Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds;
- IFRIC 6, Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment;
- IFRS 6, Exploration for and Evaluation of Mineral Resources (effective from 1 January 2006).

The effect of adoption of the above new or revised standards and interpretations on the Group's financial position at 31 December 2006 and 31 December 2005 and on the results of its operations for the years then ended was not significant.

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

- 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 introduces new disclosures to improve the information disclosed in respect of financial instruments. The volume of disclosures will increase significantly with an emphasis on quantitative aspects of risk exposures and the methods of risk management. The quantitative disclosures will provide information about the extent to which the entity is exposed to risk, based on information provided internally to the entity's key management personnel. Qualitative and quantitative disclosures will cover exposure to credit risk, liquidity risk and market risk including sensitivity analysis to market risk. IFRS 7 replaces 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 introduces disclosures about level of an entity's capital and how it manages capital. The Group is currently assessing what impact the new IFRS and the amendment to IAS 1 will have on disclosures in its financial statements;
- 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

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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;

- IFRIC 7, Applying the Restatement Approach under IAS 29 (effective for periods beginning on or after 1 March 2006, that is from 1 January 2007);
- IFRIC 8, Scope of IFRS 2 (effective for periods beginning on or after 1 May 2006, that is from 1 January 2007);
- 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);
- 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);
- IAS 23, Borrowing Cost (Amendment, applies to borrowing costs relating to qualifying assets for which the commencement date for capitalization is on or after 1 January 2009). The main change from the previous version 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.

The effect of these changes for the Group's financial statements in the period of their initial application is not known or reasonably estimable by the moment.

**Going concern.** The accompanying consolidated financial statements have been prepared on a going concern basis, which contemplates the realisation of assets and the satisfaction of liabilities in the normal course of business. The recoverability of the Group's assets, as well as the future operations of the Group, may be significantly affected by the current and future economic environment. The accompanying financial statements do not include any adjustments should the Group be unable to continue as a going concern.

**Critical accounting estimates and assumptions.** The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgments 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 judgments, apart from those involving estimations, in the process of applying the accounting policies. Judgments that have the most significant effect on the amounts recognized in the 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 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 prior estimates. If there is deterioration in a major customer's creditworthiness or actual defaults are higher than the estimates, the actual results could differ from these estimates.

#### *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 property, plant and equipment has declined below the carrying value. The recoverable amount of property, plant and equipment is the higher of an asset's fair value less costs to

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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 statement of income in the period in which the reduction is identified. If conditions change and management determines that the value of property, plant and equipment has increased, the impairment provision will be fully or partially reversed.

*Useful lives of property, plant and equipment*

The estimation of the useful lives of an item of property, plant and equipment is a matter of management judgment based upon experience with similar assets. In determining the useful life of assets, 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.

*Tax contingencies*

Russian tax legislation is subject to varying interpretations and changes, which can occur frequently. Where the Group management believes it is probable that their interpretation of the relevant legislation and the Group's tax positions cannot be sustained, an appropriate amount is accrued for in these IFRS financial statements.

*Carve-out methodologies*

These consolidated and combined financial statements include carved out financial statement data of Surgutskaya GRES-1 and Serovskaya GRES for the periods prior to and from the predecessor legal entities as outlined in the table below.

| <b>Power stations</b> | <b>Predecessor legal entity</b> | <b>Period requiring carve-out accounting</b> |
|-----------------------|---------------------------------|--|
| Surgutskaya GRES-1    | Tyumenenergo                    | 6 months ended 30 June 2005                  |
| Serovskaya GRES       | Sverdlovennergo                 | 3 months ended 31 March 2005                 |

In carving out this financial statement data, the following determinations were made:

- electricity and heat sales were based on actual electricity and heat power production volume multiplied by actual tariffs approved by RTSs for the power stations (Surgutskaya GRES-1 and Serovskaya GRES) after their spin-off from the predecessor legal entities for the year 2005;
- operating expenses were determined on an actual basis;
- depreciation of property, plant and equipment was calculated on IFRS predecessor values;
- general and administrative overheads were not allocated but were determined on an actual basis;
- current profit tax was determined using the effective profit tax rate of the predecessor entities;
- deferred profit tax was determined from movements in deferred tax assets/liabilities between 1 January 2005 and the date of set up of the power stations as stand-alone legal entities;
- property, plant and equipment were based on IFRS predecessor values and rolled back to 1 January 2005 taking into account additions and disposals before their spin-off;
- accounts payable, taxes payable, accounts receivable, inventories were determined on an actual basis.

**Note 4. Summary of significant accounting policies**

**Principles of consolidation.** The Financial Statements comprise the financial statements of OJSC OGK-2 and the financial statements of those entities whose operations are controlled by OJSC OGK-2. Control is presumed to exist when JSC OGK-2 controls, directly or indirectly through subsidiaries, more than 50% of voting rights. The Group consolidates Pskovskaya GRES as an entity under common control where it owned 50% of voting shares. In this case control existed on the basis of significant shareholding combined with the fact that JSC OGK-2 had the majority in the Board of Directors of Pskovskaya GRES. The Company was the dominant owner and the Company's Parent had major influence over the subsidiary's operations through operations of Unified Energy System.

*A) Subsidiaries*

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.

*B) Transactions eliminated on consolidation*

Inter-company balances and transactions, and any unrealized gains arising from inter-company transactions, are eliminated in preparing the consolidated financial statements.

**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 contributed and share premium is accounted for in these consolidated financial statements as an adjustment to equity.

**Foreign currency.** Monetary assets and liabilities, held by the Group's entities and denominated in foreign currencies at the balance sheet date, are translated into RR at the exchange rates prevailing at the 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 the monetary assets and liabilities denominated in foreign currencies are recognized in the income statement.

As at 31 December 2006, the official rate of exchange, as determined by the Central Bank of the Russian Federation, between the RR and the US Dollar ("USD") was RR 26.33: USD1.00 (31 December 2005: RR 28.78: USD 1.00), between the RR and the EURO RR 34.70: EURO 1.00 (31 December 2005: RR 34.19: EURO 1.00).

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

**Property, plant and equipment.** In 2005 property, plant and equipment were recognized at the carrying value determined in accordance with IFRS by the Predecessor.

Property, plant and equipment are stated at depreciated cost less impairment. Deemed cost was initially determined by a third party valuation as at 31 December 1997 and restated for the impact of inflation until 31 December 2002. Adjustments are made for additions, disposals and depreciation charges. 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 statement of operations. An impairment loss recognised in prior years is reversed

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if there has been an increase in the estimated fair value or value in use used to determine an asset's recoverable amount.

The amounts determined by the third party valuation represent an estimate of depreciated replacement cost. The third party valuation was performed in order to determine a basis for cost, because the historical accounting records for property, plant and equipment were not readily available, in accordance with paragraph 16 of IAS 29. Therefore, this third party valuation is not a recurring feature since it was intended to determine the initial cost basis of property, plant and equipment and the Group has not adopted a policy of revaluation on subsequent measurement.

Renewals and improvements are capitalized and the assets replaced are retired. The cost of repair and maintenance are expensed as incurred. Gains and losses arising from the retirement of property, plant and equipment are included in the income statement as incurred.

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

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. For the property, plant and equipment which were subject to an independent valuation as at 31 December 1997, the depreciation rate applied is based on the estimated remaining useful lives as at 31 December 1997. The remaining useful lives of property, plant and equipment are reviewed annually.

The useful lives, used for depreciation calculation up to 2005, in years, are as follows:

| Type of facility                | Acquired prior to<br>31 December 1997 | Acquired subsequent to<br>31 December 1997 |
|---------------------------------|---------------------------------------|--|
| Electricity and heat generation | 7-60                                  | 20-50                                      |
| Other                           | 3-40                                  | 10   |

In 2005 and 2006 management re-assessed remaining useful lives of property, plant and equipment and applied them to calculation of depreciation expense for 2005 and 2006 respectively:

| Type of facility                           | Remaining useful lives<br>re-assessed at<br>01 January 2005 | Remaining useful lives<br>re-assessed at<br>01 January 2006 |
|--|---|---|
| Electricity and heat generation including: | 10-66   | 4-66  |
| Other                                      | 7-10  | 7-22  |

**Cash and cash equivalents.** Cash comprises cash in hand and cash deposited on demand at banks. Cash equivalents comprise short-term highly liquid investments that are readily convertible into cash and have a maturity of three months or less from the date of acquisition and are subject to insignificant changes in value.

**Accounts receivable and prepayments.** Accounts receivable are recorded inclusive of value added taxes. Accounts receivable are recognized initially at fair value and subsequently measured at amortised cost using the effective interest rate method less provision for impairment. Such provision for doubtful debtors is established if there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables. The amount of the allowance is the difference between the carrying amount and the recoverable amount, being the present value of expected cash flows, discounted at the market rate of interest for similar borrowers at the date of origination of receivables. In practice, the entity has estimated that the nominal amount of accounts receivable approximates the fair value at inception.

Differences in tariffs between the sale and purchase of electricity through FOREM (Federal Wholesale Electricity (Power) Market) resulted in unallocated balances (tariff imbalance). These imbalances and related revenues were not recognised in the Group's accounts.

The deferred value added tax ("VAT") and profit tax were recognized in relation to the above tariff imbalance represented liabilities to the budget and was reflected in the balance sheet until the specified VAT and profit tax returns for their reversal were submitted to tax authorities.

As part of the state reform of the electricity sector as at 1 September 2006 new rules on wholesale electricity (power) market implemented (see Note 1) which eliminated the instances of tariff imbalance, as suppliers and consumers of electricity conclude bilateral contracts with agreed tariffs.

**Value added tax on purchases and sales.** Output 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 recognized in the balance sheet on a gross basis and disclosed separately as an asset and liability. Where provision has been made for impairment of receivables, impairment loss is recorded for the gross amount of the debtor, including VAT. The related deferred VAT liability is maintained until the debtor is written off for tax purposes.

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

**Intangible assets.** Intangible assets acquired separately are reported at cost less accumulated amortisation and accumulated impairment losses. Amortisation is charged on a straight-line basis over their estimated useful lives. The estimated useful life and amortisation method are reviewed at the end of each annual reporting period, with the effect of any changes in estimate being accounted for on a prospective basis.

**Income tax.** The income tax expense represents the sum of the tax currently payable and deferred income tax. The tax currently payable is based on taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted by the balance sheet date.

**Deferred income tax.** Deferred tax is provided using the balance sheet liability method for the temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for the 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 or loss. 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 utilized. Deferred tax assets and liabilities are netted only within the individual companies of the Group. 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 utilized.

Deferred tax movements are recorded in the income statement except when they are related to the items directly charged to the shareholders' equity. In this case deferred taxes are recorded as part of the shareholders' equity.

**Accounts payable and accrued charges.** Accounts payable are stated inclusive of value added tax. Trade payables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest rate method. If accounts payable are restructured and the discounted present value of the cash flows under the restructured terms discounted using the original effective interest rate differs by more than ten percent from the discounted present value of the remaining cash flows of the original financial liability, then the fair value of the restructured payable is measured as the discounted present value of the cash flows under the restructured terms. In this case the amount of the discount is credited to



the income statement (finance costs) as a gain on restructuring, and the non-current portion of the discounted payable is reclassified to other non-current liabilities. The discount is amortized over the period of the restructuring as an interest expense.

**Debt.** Debt is recognized initially at its' fair value. If it is significantly different from the transaction price, fair value is determined using the prevailing market interest rate for a similar instrument. In subsequent periods, debt is stated at amortized cost using the effective yield method; any difference between the fair value at initial recognition (net of transaction costs) and the redemption amount is recognized in the income statement as an interest expense over the period of the debt obligation.

**Borrowing Costs.** The Group applies the benchmark treatment of IAS 23 "Borrowing costs" and recognises all borrowing costs as an expense in the period in which they are incurred.

**Finance leases.** Where the Group is a lessee in a lease which transferred substantially all the risks and rewards incidental to ownership to the Group, the assets leased are capitalised in property, plant and equipment at the commencement of the lease at the lower of the fair value of the leased asset and the present value of the minimum lease payments. The corresponding rental obligations, net of future finance charges, are included in debts. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding. The interest cost is charged to the statement of operations over the lease period using the effective interest method.

**Operating leases.** Where the Group is a lessee in a lease which does not transfer substantially all the risk and rewards incidental to ownership from the lessor to the Group, the total lease payments, including those on expected termination, are charged to profit or loss on a straight-line basis over the period of the lease.

When assets are leased out under an operating lease, the lease payments receivable are recognised as rental income on a straight-line basis over the lease term.

**Minority interest.** Minority interest represents the minority shareholders' proportionate share of the equity and results of operations of the Group'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.

**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 and included in employee benefit expenses and payroll taxes in the statements of operations.

Benefit plans define 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 less the fair value of plan assets, together with adjustments for unrecognised actuarial gains or losses. The defined benefit obligations are calculated using the projected unit credit method. The present value of the defined benefit obligations are determined by discounting the estimated future cash outflows using interest rates of government bonds that are denominated in the currency in which the benefits will be paid associated with the operation of the plans, and that have terms to maturity approximating the terms of the related pension liabilities.

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 statement of operations over the employees' expected average remaining working lives.

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

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**Revenue recognition.** Revenue is recognized on the delivery of electricity and heat during the period. Revenues are measured at the fair value of consideration received or receivable. Revenue amounts are represented exclusive of value added tax.

**Segment reporting.** The Group operates predominantly in a single geographical area and industry, the generation of electric power and heat in the Russian Federation.

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

**Fair value measurement.** The fair value of accounts receivable for disclosure purposes is measured by discounting the value of expected cash flows at the market rate of interest for similar borrowers at the reporting date.

The fair value of financial liabilities and other financial instruments (except if publicly quoted) for disclosure purposes is measured by discounting the future contractual cash flows at the current market interest rate available to the Group for similar financial instruments. The fair value of publicly quoted financial instruments for disclosure purposes are measured based on current market value at the close of business on the reporting date.

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

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

**Note 5. Related Parties**

The nature of the related party relationships for those related parties with whom the Group entered into significant transactions in 2006 and in 2005 or had significant balances outstanding at 31 December 2006 and at 31 December 2005 are detailed below.

**Parent**

Transactions with the Parent were as follows:

|                   | Year ended<br>31 December 2006 | Year ended<br>31 December 2005 |
|-------------------|--------------------------------|--------------------------------|
| Dividends accrued | 565,139                        | 122,042                        |

Balances with Parent at the end of the periods were as follows:

|                  | 31 December 2006 | 31 December 2005 |
|------------------|------------------|------------------|
| Accounts payable | 173,441          | 214,512          |

**Transactions with the Parent's subsidiaries and associates**

Transactions with the Parent's subsidiaries were as follows:

|                      | Year ended<br>31 December 2006 | Year ended<br>31 December 2005 |
|----------------------|--------------------------------|--------------------------------|
| Sales of electricity | 22,333,382                     | 16,798,898                     |
| Other sales          | 222,068                        | 79,739                         |

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Balances with Parent's subsidiaries at the end of the periods were as follows:

|   | 31 December 2006 | 31 December 2005 |
|---|------------------|------------------|
| Accounts receivable, gross                      | 966,650          | 1,945,921        |
| Provision for impairment of accounts receivable | (449,429)        | (866,365)        |
| Accounts payable                                | 129,443          | 45,805           |

**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 FTS. Bank loans are granted at market rates. Taxes are charged and paid under the Russian tax legislation.

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

|  | Year ended<br>31 December 2006 | Year ended<br>31 December 2005 |
|--|--------------------------------|--------------------------------|
| Sales of heat, condensate and utilities services | 181,837                        | 157,502                        |
| Purchase of fuel                                 | 5,942,178                      | 3,646,336                      |

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

|  | 31 December 2006 | 31 December 2005 |
|--|------------------|------------------|
| Accounts receivable and prepayments                  | 79,026           | 110,463          |
| Bad debt provision                                   | (48,449)         | (71,867)         |
| Accounts payable and accruals                        | 175,321          | 76,693           |
| Non-current debt                                     | -                | 140,000          |
| Current debt and current portion of non-current debt | 1,504,800        | 410,078          |

Interest expense accrued for the year ended 31 December 2006 was RR 74,821 thousands (2005: RR 77,975 thousands).

Tax balances are disclosed in the balance sheet and Notes 13 and 17. Tax transactions are disclosed in the Group's statement of operations and Notes 13 and 20.

**Transactions with key management**

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

Fees, compensation or allowances to the members of the Board of Directors for their services in that capacity and for attending Board meetings are paid depending on results for the year.

In 2006 the Company provided guarantees to the third parties for the members of the Management Board of RR 70,597 thousand. In 2005 no guarantees were provided.

Total remuneration in the form of salary and bonuses paid to the members of the Board of Directors and Management Board for the year ended 31 December 2006 was RR 81,749 thousand (for the year ended 31 December 2005 – RR 8,900 thousand). Total remuneration in the form of salary and bonuses accrued

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to the members of the Board of Directors and Management Board for the year ended 31 December 2006 was RR 102,328 thousand.

There are no transactions or balances with key management besides their remuneration in the form of salary and bonuses.

**Note 6. Property, plant and equipment**

| <b>Cost</b>  | <b>Electricity and heat generation</b> | <b>Construction in progress</b> | <b>Other</b>       | <b>Total</b>        |
|--|--|---------------------------------|--------------------|---------------------|
| Opening balance as at 1 January 2005                   | 23,405,691                             | 1,363,304                       | 2,895,430          | 27,664,425          |
| Additions  | 31,522                                 | 423,957                         | 242,130            | 697,609             |
| Transfer   | 119,948                                | (235,908)                       | 115,960            | -                   |
| Disposals  | (5,308)                                | (54,094)                        | (7,011)            | (66,413)            |
| <b>Closing balance as at 31 December 2005</b>          | <b>23,551,853</b>                      | <b>1,497,259</b>                | <b>3,246,509</b>   | <b>28,295,621</b>   |
| <b>Accumulated depreciation (including impairment)</b> |  |                                 |                    |                     |
| Opening balance as at 1 January 2005                   | (12,691,779)                           | (509,723)                       | (2,185,817)        | (15,387,319)        |
| Charge for the period                                  | (754,706)                              | -                               | (101,604)          | (856,310)           |
| Reversal/(charge) of impairment loss                   | 1,235,900                              | (321,652)                       | 226,233            | 1,140,481           |
| Transfers  | (32,843)                               | 89,985                          | (57,142)           | -                   |
| Disposals  | 2,627                                  | 1,833                           | 2,817              | 7,277               |
| <b>Closing balance as at 31 December 2005</b>          | <b>(12,240,801)</b>                    | <b>(739,557)</b>                | <b>(2,115,513)</b> | <b>(15,095,871)</b> |
| <b>Net book value as at 31 December 2005</b>           | <b>11,311,052</b>                      | <b>757,702</b>                  | <b>1,130,996</b>   | <b>13,199,750</b>   |
| <b>Net book value as at 31 December 2004</b>           | <b>10,713,912</b>                      | <b>853,581</b>                  | <b>709,613</b>     | <b>12,277,106</b>   |

| <b>Cost</b>  | <b>Electricity and heat generation</b> | <b>Construction in progress</b> | <b>Other</b>       | <b>Total</b>        |
|--|--|---------------------------------|--------------------|---------------------|
| Opening balance as at 1 January 2006                   | 23,551,853                             | 1,497,259                       | 3,246,509          | 28,295,621          |
| Additions  | 1,723                                  | 759,161                         | 181,366            | 942,250             |
| Transfer   | 318,750                                | (420,570)                       | 101,820            | -                   |
| Disposals  | (294,394)                              | (56,536)                        | (129,229)          | (480,159)           |
| <b>Closing balance as at 31 December 2006</b>          | <b>23,577,932</b>                      | <b>1,779,314</b>                | <b>3,400,466</b>   | <b>28,757,712</b>   |
| <b>Accumulated depreciation (including impairment)</b> |  |                                 |                    |                     |
| Opening balance as at 1 January 2006                   | (12,240,801)                           | (739,557)                       | (2,115,513)        | (15,095,871)        |
| Charge for the period                                  | (686,151)                              | -                               | (169,672)          | (855,823)           |
| Reversal of impairment loss                            | 4,030,294                              | 141,441                         | 135,424            | 4,307,159           |
| Transfers  | -                                      | -                               | -                  | -                   |
| Disposals  | 169,761                                | -                               | 63,087             | 232,848             |
| <b>Closing balance as at 31 December 2006</b>          | <b>(8,726,897)</b>                     | <b>(598,116)</b>                | <b>(2,086,674)</b> | <b>(11,411,687)</b> |
| <b>Net book value as at 31 December 2006</b>           | <b>14,851,035</b>                      | <b>1,181,198</b>                | <b>1,313,792</b>   | <b>17,346,025</b>   |
| <b>Net book value as at 31 December 2005</b>           | <b>11,311,052</b>                      | <b>757,702</b>                  | <b>1,130,996</b>   | <b>13,199,750</b>   |

The assets transferred to the Group did not include the land on which the Group's buildings and facilities are situated. The Group has the right to purchase this land upon application to the state registration body or to formalize the right for rent after the right expiry date, which is 1 January 2008.

***Impairment provision for property, plant and equipment***

The impairment provision included in accumulated depreciation balance as at 31 December 2006 is RR 598,116 thousand (as at 31 December 2005 – RR 5,211,788 thousand).

Management has concluded that at 31 December 2005 and at 31 December 2006 there were indications for reversing previously recognised impairment losses for those generating units that were controlled by the Group at respective reporting date. These conclusions are based on significant changes with a favourable effect on the Group that have occurred or are expected to occur in the near future in the market and economic environment in which the Group operates. Such changes include:

- a) upward revisions, based on recent trends, in the expected growth of demand for electricity and heat in the regions in which the Group operates;
- b) higher degree of certainty about the free trading sector for electricity, which has been enacted by the government of the Russian Federation as of August 2006 (see Note 1).

These developments together with reassessed useful lives have resulted in a change to the assumptions that were used to determine the value in use of assets that comprise the cash generating units. An impairment review has been carried out by comparing the recoverable amount of the individual cash generating units with their net book values. For the purposes of the review, each of the Group's power plants was used as the relevant cash generating unit. The recoverable amount was generally based on value in use, which was calculated based on estimated future cash flows using various assumptions. Particularly, the Group expects the electricity and heat tariffs will grow in a way to compensate increase in gas prices and other operating costs and provide higher rate of return than it was before. The post-tax discount rate used for assessment of value in use is equal to 13.33%.

Consequently, the change in management's assessments has resulted in the reversal of the previously recognized impairment loss to the extent of RR 1,462,133 thousand at 31 December 2005 (for plants that were under Company's control as at 31 December 2005) and RR 4,165,718 thousand at 31 December 2006 (primarily for plants for which control has been obtained by the Company in 2006). A respective gain together with a corresponding deferred tax expense of RR 350,912 thousands and RR 999,773 thousand was recognised in the income statement for the year ended 31 December 2005 and for the year ended 31 December 2006, respectively.

In addition to this in 2005 management assessed that additional impairment provision of RR 321,652 thousands is necessary in relation to certain construction in progress objects which were not planned for completion. In 2006 this impairment was partially reversed in amount of RR 141,441 thousand in respect of objects that were included into new Company's investment program.

***Leased property, plant and equipment***

The Group leased certain equipment under a number of finance lease agreements. In some cases at the end of the leases the Group has the option to purchase the equipment at a beneficial price, in other cases at the end of the leases the Group receives the equipment in ownership without additional payments. As at 31 December 2006 the net book value of leased property, plant and equipment was RR 227,434 thousand (as at 31 December 2005 RR 249,096 thousand). The leased equipment secures lease obligations.

***Operating lease***

The Company leases a number of land areas owned by local governments under operating lease. Land lease payments are determined by lease agreements.

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Non-cancelable operating lease rentals are payable as follows:

|   | <b>31 December 2006</b> | <b>31 December 2005</b> |
|---|-------------------------|-------------------------|
| Not later than one year                           | 60,021                  | 8,629                   |
| Later than one year and not later than five years | 297,509                 | 23,452                  |
| Later than five years                             | 19,361                  | 2,489                   |
| <b>Total</b>                                      | <b>376,891</b>          | <b>34,570</b>           |

The land areas leased by OJSC OGK-2 are the territories on which the Company's electric power stations, stations and other assets are located. Lease payments are reviewed regularly to reflect market rentals.

**Note 7. Intangible assets**

|                                       | <b>SAP R-3<br/>software</b> | <b>Other intangibles</b> | <b>Total intangible<br/>assets</b> |
|---------------------------------------|-----------------------------|--------------------------|------------------------------------|
| <b>Balance as at 1 January 2005</b>   | -                           | <b>3,612</b>             | <b>3,612</b>                       |
| Additions                             | 83,241                      | 1,979                    | 85,220                             |
| Disposals                             | -                           | -                        | -                                  |
| <b>Balance as at 31 December 2005</b> | <b>83,241</b>               | <b>5,591</b>             | <b>88,832</b>                      |
| Additions                             | 211,506                     | -                        | 211,506                            |
| Disposals                             | -                           | (1,477)                  | (1,477)                            |
| <b>Balance as at 31 December 2006</b> | <b>294,747</b>              | <b>4,114</b>             | <b>298,861</b>                     |

Intangible assets include cost incurred and prepayments made in respect of implementation of SAP R-3 software. Amortization of software will be started on completion of the implementation projects.

**Note 8. Other non-current assets**

|   | <b>31 December 2006</b> | <b>31 December 2005</b> |
|---|-------------------------|-------------------------|
| Restructured trade and other receivables<br>(net of provision for impairment of accounts receivable of<br>RR 263,929 thousand as at 31 December 2006 and RR 302,186<br>thousand as at 31 December 2005) | 188,489                 | 143,349                 |
| Other   | 23,353                  | 27,667                  |
| <b>Total</b>  | <b>211,842</b>          | <b>171,016</b>          |

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**Note 9. Accounts receivable and prepayments**

|   | <b>31 December 2006</b> | <b>31 December 2005</b> |
|---|-------------------------|-------------------------|
| Trade receivables<br>(net of provision for impairment of accounts receivable of RR 376,664 thousand as at 31 December 2006 and RR 835,835 thousand as at 31 December 2005)                              | 614,108                 | 1,009,511               |
| Advances to suppliers<br>(net of provision for impairment of advances to suppliers of RR 3,427 thousand as at 31 December 2005)   | 729,314                 | 236,414                 |
| Prepayments and accrued income  | 51,092                  | 81,780                  |
| Prepaid value-added tax   | 208,853                 | 28,134                  |
| Value added tax recoverable   | 63,937                  | 323,909                 |
| Other receivables<br>(net of provision for impairment of accounts receivable of RR 123,855 thousand as at 31 December 2006 and RR 216,995 thousand as at 31 December 2005)                              | 438,588                 | 359,768                 |
| <b>Total</b>  | <b>2,105,892</b>        | <b>2,039,516</b>        |
| Less: Restructured trade and other receivables<br>(net of provision for impairment of accounts receivable of RR 263,929 thousand as at 31 December 2006 and RR 302,186 thousand as at 31 December 2005) | (188,489)               | (143,349)               |
| <b>Total</b>  | <b>1,917,403</b>        | <b>1,896,167</b>        |

Management has determined the provision for impairment of accounts receivable based on specific customer identification, customer payment trends, subsequent receipts and settlements and analyses of expected future cash flows. The effects of discounting are reflected in the provision for impairment of accounts receivable and expense. Management of the Group believes that Group entities will be able to realize the net receivable amount through direct collections and other non-cash settlements, and therefore the recorded value approximates their fair value.

**Note 10. Inventories**

|                        | <b>31 December 2006</b> | <b>31 December 2005</b> |
|------------------------|-------------------------|-------------------------|
| Fuel supplies          | 1,177,585               | 481,659                 |
| Materials and supplies | 333,163                 | 323,549                 |
| Spare parts            | 469,995                 | 387,335                 |
| <b>Total</b>           | <b>1,980,743</b>        | <b>1,192,543</b>        |

The above inventory balances are recorded net of an obsolescence provision of RR 35,083 thousand and RR 80,826 thousand as at 31 December 2006 and 31 December 2005, respectively.

Inventory balances as at 31 December 2006 and 31 December 2005 included RR 409,013 thousand and RR 442,497 thousand, respectively, of inventory which were pledged as collateral according to loan agreements.

**Note 11. Other current assets**

|  | 31 December 2006 | 31 December 2005 |
|--|------------------|------------------|
| Short-term deposits (7.5%)                 | 500,000          | -                |
| Bank promissory notes (zero interest rate) | 41,542           | 3,440            |
| Other short-term investments               | 167              | 597              |
| <b>Total</b>                               | <b>541,709</b>   | <b>4,037</b>     |

**Note 12. Equity**

***Basis of presentation of movements in equity***

The Group was formed by the combination of a number of businesses under common control. Because of the consequent use of the predecessor basis of accounting (see Note 3), the principal component of the net equity recognised for the Group is based on the historic carrying value of the net assets of the businesses contributed as recorded in the IFRS financial records of the predecessor enterprises, rather than the fair values of those net assets. Similarly, for the purpose of comparability, the equity of the Group has been presented for comparative periods and as at 1 January 2005 as if the current Group structure had existed from 1 January 2005 (see Note 3). As the Group was formed as a result of a series of share issues completed after 1 January 2005, the equity statement reflects additions to share capital in the amount equal to the statutory nominal value of the shares issued and share premium which are based on the fair value of the net assets of the businesses contributed. In accordance with the predecessor basis of accounting, the effect of such additions to equity is offset by a corresponding decrease in the merger reserve and reduction in minority interest.

***Share capital***

***Share capital***

| <i>(Number of shares unless otherwise stated)</i> | <b>Ordinary shares<br/>31 December 2006</b> | <b>Ordinary shares<br/>31 December 2005</b> |
|---|---|---|
| Issued shares                                     | 26,480,895,818                              | 10,769,803,935                              |
| Par value (in RR)                                 | 1.00  | 1.00  |

As at 31 December 2006 number of issued ordinary shares is 26,480,895,818 with a par value of RR 1.00 each. The authorised and not yet issued as at 31 December 2006 number of ordinary shares is 1,574,482,417 with a par value of RR 1.00 each.

***Transaction with the Parent***

In March 2005 the Parent transferred to the Company 51.00%, 50.00% and 100% less 1 share of the outstanding ordinary shares of Stavropolskaya GRES, Pskovskaya GRES and Troitskaya GRES respectively for the total amount of RR 10,748,729 thousand. The values of shares in the Company's subsidiaries were determined by independent appraisers.

Also in 2005 the Parent paid cash contributions amounted to RR 21,075 thousand.

In the second quarter 2006 the Company issued 14,547,265,563 shares paid in kind by 94.78%, 100%, 40.69% and 24.63% of the outstanding ordinary shares of Serovskaya GRES, Surgutskaya GRES-1, Stavropolskaya GRES and Pskovskaya GRES. The shares were paid by the Parent and the minorities.

As of result of share issue in the second quarter 2006 the Parent transferred to the Company 65.33% and 100% of the outstanding ordinary shares of Serovskaya GRES and Surgutskaya GRES-1 respectively in exchange for the ordinary shares of the Company with nominal value of RR 10,781,306 thousand. The value of the shares, transferred by the Parent, as determined by the independent appraiser, amounted to RR 767,434 thousand and RR 11,361,535 thousand respectively. Difference between nominal value of



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ordinary shares of the Company and value of the shares transferred by the Parent of RR 1,347,663 thousand was recorded as share premium.

**Transactions with minority shareholders**

As a result of the share issue, in the second quarter 2006 the minority shareholders exchanged 40.69%, 24.63% and 29.45% of the outstanding ordinary shares of Stavropolskaya GRES, Pskovskaya GRES and Serovskaya GRES respectively for the ordinary shares of OGK-2. The difference of RR 470,745 thousand between the values of the shares received from the minority shareholders of RR 4,236,704 thousand as determined by independent appraiser and nominal value of shares issued by the Company of RR 3,765,959 thousand was recorded as share premium.

On 29 September 2006 the Company issued 1,163,826,320 shares, which were paid by 8.26%, 25.37% and 5.22% of outstanding minority ordinary shares of Stavropolskaya GRES, Pskovskaya GRES and Serovskaya GRES. The coefficients used for the shares exchange were approved by the Company's Board of Directors and were based on the independent appraiser's evaluation. As a result of the share exchange no share premium was recognized.

The difference RR 15,362,174 thousand between the nominal value of the shares issued by the Company in the second quarter 2006 and September 2006 and exchanged with the Parent and minority shareholders, share premium and book value of the minority interest was charged to merger reserve.

Following this, Stavropolskaya GRES, Pskovskaya GRES, Surgutskaya GRES-1, Troitskaya GRES and Serovskaya GRES were merged with the Company and ceased to be separate legal entities.

**Summary of transactions with the Parent and minority shareholders**

Summary of transactions with share capital is provided below:

|   | Pskovskaya<br>GRES | Serovskaya<br>GRES | Stavropolskaya<br>GRES | Surgutskaya<br>GRES-1 | Troitskaya<br>GRES |
|---|--------------------|--------------------|------------------------|-----------------------|--------------------|
| March 2005 - issued to<br>RAO UES           | 50.00%             | -                  | 51.00%                 | -                     | 100%               |
| Purchases during 2005 -<br>on the market    | -                  | -                  | 0.05%                  | -                     | -                  |
| Second quarter 2006 -<br>issued to RAO UES  | -                  | 65.33%             | -                      | 100%                  | -                  |
| Second quarter 2006 -<br>issued to minority | 24.63%             | 29.45%             | 40.69%                 | -                     | -                  |
| 29 September 2006 -<br>issued to minority   | 25.37%             | 5.22%              | 8.26%                  | -                     | -                  |
| <b>Total</b>                                | <b>100.00%</b>     | <b>100.00%</b>     | <b>100.00%</b>         | <b>100.00%</b>        | <b>100.00%</b>     |

**Merger reserve**

As described in the paragraph "predecessor accounting (see Note 3) and paragraph "transfers of subsidiaries from the parties under common control" (see Note 4), the Company accounted for the transactions as of 1 January 2005.

The difference of RR 8,602,206 thousand between the IFRS carrying value of the contributed assets as at 1 January 2005 and the minority interest has been recorded as a merger reserve within equity attributable to the Company's shareholders.

**Dividends**

The Company's annual statutory accounts form the basis for the annual profit distribution and other appropriations. The specific Russian legislation identifies the basis of distribution as the net profit. However, this legislation and other statutory laws and regulations dealing with the distribution rights are

open to legal interpretation and, accordingly, management believes at present it would not be appropriate to disclose an amount for the distributable reserves in these financial statements.

In September 2005 Pskovskaya GRES declared interim dividends for six months of 2005 of RR 0.0858 per share for the total of RR 6,812 thousand, out of which RR 3,406 and RR 3,406 were payable to the Company and the minority shareholders respectively. These dividends were recognized as liability and deducted from equity at 31 December 2005.

In December 2005 Pskovskaya GRES declared interim dividends for nine months of 2005 of RR 0.016082 per share for the total of RR 12,768 thousand, out of which RR 6,384 and RR 6,384 were payable to the Company and the minority shareholders respectively. These dividends were recognized as liability and deducted from equity at 31 December 2005.

In September 2005 Stavropolskaya GRES declared interim dividends for six months of 2005 of RR 81.134 per share for the total of RR 110,205 thousand, out of which RR 56,246 and RR 53,959 were payable to the Company and the minority shareholders respectively. These dividends were recognized as liability and deducted from equity at 31 December 2005.

In December 2005 Stavropolskaya GRES declared interim dividends for nine months of 2005 of RR 76.4611 per share for the total of RR 103,875 thousand, out of which RR 53,024 and RR 50,851 were payable to the Company and the minority shareholders respectively. These dividends were recognized as liability and deducted from equity at 31 December 2005.

In December 2005 Surgutskaya GRES-1 declared interim dividends for nine months of 2005 of RR 0.199383 per share for the total of RR 54,580 thousand, which were totally payable to the Parent. These dividends were recognized as liability and deducted from equity at 31 December 2005.

In December 2005 the Company declared interim dividends for nine months of 2005 of RR 0.006264 per share for the total of RR 67,348 thousands, which were totally payable to the Parent. These dividends were recognized as a liability and deducted from equity at 31 December 2005.

In April 2006 the Company declared final dividends for the year ended 31 December 2005 of RR 0.011836 per share for the total of RR 127,471 thousands, which were totally payable to the Parent. These dividends were recognized as a liability and deducted from equity at 31 December 2006.

In April 2006 Surgutskaya GRES declared interim dividends for three months ended 31 March 2006 of RR 1.315122 per share for the total of RR 361,832 thousand, which were totally payable to the Parent. These dividends were recognized as a liability and deducted from equity at 31 December 2006.

In June 2006 Pskovskaya GRES declared final dividends for the year ended 31 December 2005 of RR 0.013185 per share for the total of RR 10,468 thousand, out of which RR 7,819 and RR 2,649 were payable to the Company and the minority shareholders respectively. These dividends were recognized as liability and deducted from equity at 31 December 2006.

In June 2006 Stavropolskaya GRES declared interim dividends for three months of 2006 of RR 36.804 per share for the total of RR 50,000 thousand, out of which RR 45,871 and RR 4,129 were payable to the Company and the minority shareholders respectively. These dividends were recognized as liability and deducted from equity at 31 December 2006.

In September 2006 the Company declared interim dividends for the six months ended June 30, 2006 of RR 0,003539 per share for the total of RR 89,597 thousand, out of which RR 76,023 thousand were payable to the Parent and RR 13,574 thousand were payable to other Company's shareholders. These dividends were recognized as a liability and deducted from equity at 31 December 2006.

All dividends payable to the Company are eliminated as intercompany transactions.

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**Note 13. Income tax**

| <i>Income tax charge</i>       | Year ended<br>31 December 2006 | Year ended<br>31 December 2005 |
|--------------------------------|--------------------------------|--------------------------------|
| Current income tax charge      | 91,544                         | 223,827                        |
| Deferred income tax charge     | 863,834                        | 374,515                        |
| <b>Total income tax charge</b> | <b>955,378</b>                 | <b>598,342</b>                 |

During the year ended 31 December 2006 the Group entities were subject to a 24% income tax rate on taxable profits.

In accordance with Russian tax legislation, tax losses in different Group companies may not be offset against taxable profits of other Group companies. Accordingly, tax may accrue even where there is a net consolidated tax loss.

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

|   | Year ended<br>31 December 2006 | Year ended<br>31 December 2005 |
|---|--------------------------------|--------------------------------|
| <b>Profit before tax</b>  | <b>3,389,391</b>               | <b>1,152,588</b>               |
| Theoretical tax benefit/(charge) at the statutory tax rate of 24% | (813,454)                      | (276,621)                      |
| Taxes reversal/(charge) on WEM imbalance                          | 51,113                         | (112,058)                      |
| Tax penalties forgiveness and other tax releases                  | -                              | 139,344                        |
| Change in tax base  | -                              | (237,783)                      |
| Other non-deductible and non-taxable items, net                   | (193,037)                      | (111,224)                      |
| <b>Total income tax charge</b>                                    | <b>(955,378)</b>               | <b>(598,342)</b>               |

In 2005 management reassessed tax amount to be recovered in foreseeable future from some of construction in progress balances and some of accounts receivable balances that resulted in deferred tax expense recognition of RR 237,783 thousands.

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

Since the date of merger, 29 September 2006, the Company became a single tax payer in terms of both past and future tax obligations. The Company estimates its current and deferred income tax obligations on net basis as follows:

**Deferred tax liabilities**

|                               | 31 December 2005   | Movement for the<br>year recognized in<br>the income<br>statement | 31 December 2006   |
|-------------------------------|--------------------|---|--------------------|
| Property, plant and equipment | (2,006,674)        | (859,902)   | (2,866,576)        |
| Intangible assets (SAP R-3)   | (19,978)           | (50,761)  | (70,739)           |
| Other                         | (14,417)           | 14,417  | -                  |
| <b>Total</b>                  | <b>(2,041,069)</b> | <b>(896,246)</b>  | <b>(2,937,315)</b> |

Property, plant and equipment movement includes a deferred tax expense of RR 999,773 thousands in relation to reversal of impairment loss for the amount of RR 4,165,718 thousands (see Note 6).

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**Deferred tax assets**

|   | 31 December 2005 | Movement for the<br>year recognized in<br>the income<br>statement | 31 December 2006 |
|---|------------------|---|------------------|
| Tax losses carried forward                      | 1,811            | 116,524   | 118,335          |
| Provision for impairment of accounts receivable | 64,995           | 24,316  | 89,311           |
| Finance lease                                   | 52,112           | (14,976)  | 37,136           |
| Inventory provision                             | 20,801           | (16,814)  | 3,987            |
| Accounts payable                                | 64,955           | (76,638)  | (11,683)         |
| <b>Total</b>                                    | <b>204,674</b>   | <b>32,412</b>   | <b>237,086</b>   |

|                                      | 31 December 2005   | Movement for the<br>year recognized in<br>the income<br>statement | 31 December 2006   |
|--------------------------------------|--------------------|---|--------------------|
| Total deferred tax liabilities       | (2,041,069)        | (896,246)   | (2,937,315)        |
| Total deferred tax assets            | 204,674            | 32,412  | 237,086            |
| <b>Deferred tax liabilities, net</b> | <b>(1,836,395)</b> | <b>(863,834)</b>  | <b>(2,700,229)</b> |

**Note 14. Non-current debt**

|  | Currency | Effective<br>interest rate | Due       | 31 December<br>2006 | 31 December<br>2005 |
|--|----------|----------------------------|-----------|---------------------|---------------------|
| OAO Evrofinance                        |          |                            |           |                     |                     |
| Mosnarbank                             | RR       | 10.5%                      | 2007      | 325,000             | 125,000             |
| OAO Alfa-Bank                          | RR       | 10.75%                     | 2008      | 800,000             | -                   |
| OAO Sberbank                           | RR       | 11.8%                      | 2007      | 339,000             | 140,000             |
| ZAO Nomos-bank                         | RR       | 10.5%                      | 2007      | 1,197,000           | 100,000             |
| Finance lease liability                | RR       | 24.86%                     | 2007-2011 | 74,660              | 136,937             |
| <b>Total non-current debt</b>          | RR       |                            |           | <b>2,735,660</b>    | <b>501,937</b>      |
| Less current portion of long-term debt | RR       |                            | 2007      | (1,661,000)         | -                   |
| <b>Total</b>                           |          |                            |           | <b>1,074,660</b>    | <b>501,937</b>      |

**Maturity table**

|                              | 31 December 2006 | 31 December 2005 |
|------------------------------|------------------|------------------|
| <b>Due for repayment</b>     |                  |                  |
| Between one and two years    | 1,074,660        | 436,250          |
| Between two and three years  | -                | 53,726           |
| Between three and four years | -                | 11,961           |
| Between four and five years  | -                | -                |
| <b>Total</b>                 | <b>1,074,660</b> | <b>501,937</b>   |

All of the above bank debt is obtained at fixed interest rates.

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

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

**Leasing.** Lease liabilities are effectively secured as the rights to the leased asset revert to the lessor in the event of default.

| <b>Finance lease liabilities – minimum lease payments</b> | <b>31 December 2006</b> | <b>31 December 2005</b> |
|---|-------------------------|-------------------------|
| <b>Due for repayment</b>                                  |                         |                         |
| Less than one year  | 108,124                 | 128,417                 |
| Between one year and five years                           | 88,619                  | 184,828                 |
| Future finance charges on finance lease                   | (42,010)                | (96,114)                |
| <b>Present value of lease liabilities</b>                 | <b>154,733</b>          | <b>217,131</b>          |

Management believes that total current value of non-current debt approximates its fair value since actual interest rates approximate current market interest rates available to the Group for similar financial instruments.

**Note 15. Current debt and current portion of non-current debt**

|  | <b>Currency</b> | <b>Effective interest rate</b> | <b>31 December 2006</b> | <b>31 December 2005</b> |
|--|-----------------|--------------------------------|-------------------------|-------------------------|
| OA O Sberbank                              | RR              | 7.4%-9.5%                      | 1,165,800               | 410,078                 |
| ZAO Nomos-Bank                             | RR              | 9%-10%                         | -                       | 10,000                  |
| OA O Eurofinance Mosnarbank                | RR              | 8.5%-10.5%                     | 1,273,300               | -                       |
| OA O Transcreditbank                       | RR              | 11.5%                          | 200,000                 | 140,000                 |
| OA O MDM-Bank                              | RR              | 9.5%                           | 282,625                 | -                       |
| OA O Alfa Bank                             | RR              | 11.0%-12.5%                    | -                       | 227,500                 |
| OA O Agroimpuls                            | RR              | 11.0%                          | -                       | 86,000                  |
| OA O Promstroibank                         | RR              | 11.5%                          | -                       | 52,000                  |
| OA O Alemar                                | RR              | 11.0%                          | -                       | 25,000                  |
| Current portion of finance lease liability | RR              | 24.86%                         | 80,072                  | 80,193                  |
| Current portion of long-term debt          | RR              | -                              | 1,661,000               | -                       |
| <b>Total</b>                               |                 |                                | <b>4,662,797</b>        | <b>1,030,771</b>        |

**Note 16. Accounts payable and accruals**

|  | <b>31 December 2006</b> | <b>31 December 2005</b> |
|--|-------------------------|-------------------------|
| Trade payables                         | 962,707                 | 1,291,422               |
| Salaries and wages payable             | 213,318                 | 72,074                  |
| Accrued liabilities and other payables | 229,010                 | 202,225                 |
| Dividend payable                       | 76,057                  | 174,416                 |
| <b>Total</b>                           | <b>1,481,092</b>        | <b>1,740,137</b>        |

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**Note 17. Other taxes payable**

|                     | <b>31 December 2006</b> | <b>31 December 2005</b> |
|---------------------|-------------------------|-------------------------|
| Value added tax     | 79,391                  | 495,427                 |
| Water usage tax     | 159,730                 | 105,983                 |
| Property tax        | 39,328                  | 48,558                  |
| Social tax          | 35,076                  | 10,868                  |
| Personal income tax | 20,411                  | 1,096                   |
| Tax on dividends    | -                       | 21,081                  |
| Tax penalties       | -                       | 23,720                  |
| Other taxes         | 17,926                  | 15,225                  |
| <b>Total</b>        | <b>351,862</b>          | <b>721,958</b>          |

The value added tax figure at 31 December 2006 includes RR 78,719 thousand of deferred VAT (2005: RR 472,944 thousand), which only becomes payable to the authorities when the underlying receivable balances are either recovered or written off.

**Note 18. Pension liabilities**

The post employment and post retirement program of the company consists of the occupational pension plan and various post employment, long-term and jubilee benefits. This is a defined benefit plan, under which the participants accrue pension entitlements on the basis of a formula or defined rule. The occupational pension program comprises the main part of the program. According to the pension formulae, the pension benefit is dependent on the past service of participants and their last salary. Employees with year of birth before 1967 are entitled to the occupational pension benefits.

The defined benefit pension plan provides old age retirement pension and disability pension. The plan's old age retirement pension is conditional on the member qualifying for the State old age pension.

The company also provides various long-term and post employment benefits including death in service and death in occupational pension benefit, lump sum payments upon retirement and jubilee benefits to active employees.

Additionally the company provides financial support payments of a defined benefit nature to its former employees, who have reached age of the State old age pension. Such benefits are paid to both those who qualify for the occupational pension plan and those who do not. The company also provides jubilee benefit to its retired former employees.

As at 31 December 2006, there were 4,759 active employees eligible to the post retirement defined benefit program of the company and 2,556 recipients of the financial support benefits.

The last independent actuarial valuation of pension and other post employment and long-term benefits in accordance with the provisions of IAS 19 was performed in March 2007, with valuation date of 31 December 2006 using individual members' census data as at the valuation date.

OGK-2 Group

Notes to the Combined and Consolidated Financial Statements for the years ended  
31 December 2006 and 31 December 2005

(in thousands of Russian Roubles)

Amounts recognised in the Balance Sheets are as follows:

|  | 31 December 2006 | 31 December 2005 |
|--|------------------|------------------|
| Present value of defined benefit obligations (DBO) | 579,145          | 421,706          |
| Fair value of plan assets                          | -                | -                |
| Present value of unfunded obligations              | 579,145          | 421,706          |
| Unrecognised actuarial gains/(losses)              | (98,886)         | (33,218)         |
| Unrecognised past service (cost)/asset             | (18,505)         | 1,520            |
| <b>Net liability at the end of year</b>            | <b>461,754</b>   | <b>390,008</b>   |
| Employees' average remaining working life (years)  | 10               | 10               |
| Prepayments / deposits                             | (90,635)         | (78,955)         |
| <b>Net liability in balance sheet</b>              | <b>371,119</b>   | <b>311,053</b>   |

Assets on solidarity accounts and on individual accounts in non-state pension fund in respect of current employees were recognized as "Prepayments/ deposits". The liability recognised in the balance sheet is disclosed net of these prepayments/deposits. These prepayments/deposits are not considered as plan assets since they are not effectively restricted from withdrawal from the non-state pension fund.

Amounts recognised in the Income Statements are as follows:

|   | 31 December 2006 | 31 December 2005 |
|---|------------------|------------------|
| Current service cost  | 33,757           | 26,732           |
| Interest cost   | 26,619           | 22,952           |
| Expected return on plan assets                                  | -                | -                |
| Net actuarial losses/(gains) recognised in year                 | 6,302            | -                |
| Amortisation of past service cost                               | (152)            | -                |
| Settlement (gain)/loss  | -                | -                |
| Immediate recognition of vested prior service cost              | 41,997           | 2,063            |
| <b>Net expense recognised in the income statement (DB only)</b> | <b>108,523</b>   | <b>51,747</b>    |

Movements in the net liability recognised in the balance sheet are as follows:

|  | 31 December 2006 | 31 December 2005 |
|--|------------------|------------------|
| Net liability at start of year                 | 390,008          | 357,241          |
| Net expense recognised in the income statement | 108,523          | 51,747           |
| Benefits paid                                  | (36,777)         | (18,980)         |
| <b>Net liability at end of year</b>            | <b>461,754</b>   | <b>390,008</b>   |

**OGK-2 Group**
**Notes to the Combined and Consolidated Financial Statements for the years ended  
31 December 2006 and 31 December 2005**

(in thousands of Russian Roubles)

The key actuarial assumptions used were as follows:

|   | <b>31 December<br/>2006</b> | <b>31 December<br/>2005</b> | <b>31 December<br/>2004</b> |
|---|-----------------------------|-----------------------------|-----------------------------|
| Discount rate at 31 December                | 6.60% p.a.                  | 6.60% p.a.                  | 6.60% p.a.                  |
| Future salary increases                     | 9.20% p.a.                  | 9.20% p.a.                  | 9.20% p.a.                  |
| Future pension increases                    | 6.60% p.a.                  | 6.60% p.a.                  | 6.60% p.a.                  |
| Future financial support benefits increases | 5.00% p.a.                  | 5.00% p.a.                  | 5.00% p.a.                  |
| Staff turnover                              | 5% p.a.                     | 5% p.a.                     | 5% p.a.                     |
| Mortality                                   | Russia 1998                 | Russia 1998                 | Russia 1998                 |

Reconciliation of opening and closing balances of the present value of the defined benefit obligation (DBO):

|  | <b>31 December<br/>2006</b> | <b>31 December<br/>2005</b> |
|--|-----------------------------|-----------------------------|
| Present value of defined benefit obligations (DBO) at beginning of year      | 421,706                     | 357,241                     |
| Service cost   | 33,757                      | 26,732                      |
| Interest cost  | 26,619                      | 22,952                      |
| Plan participants' contributions   | -                           | -                           |
| Actuarial (gain)/loss  | 71,970                      | 33,218                      |
| Past service cost  | 61,870                      | 543                         |
| Benefits paid  | (36,777)                    | (18,980)                    |
| Settlement and curtailment (gain)/loss                                       | -                           | -                           |
| <b>Present value of defined benefit obligations (DBO) at the end of year</b> | <b>579,145</b>              | <b>421,706</b>              |

Funded status of the pension and other post employment and long-term obligations as well as gains/losses arising of experience adjustments is as follows:

|  | <b>31 December<br/>2006</b> | <b>31 December<br/>2005</b> |
|--|-----------------------------|-----------------------------|
| Present value of defined benefit obligations (DBO)                   | 579,145                     | 421,706                     |
| Fair value of plan assets  | -                           | -                           |
| (Surplus)/deficit in plan  | 579,145                     | 421,706                     |
| Gains/(losses) arising of experience adjustments on plan liabilities | (71,970)                    | (33,218)                    |
| Gains/(losses) arising of experience adjustments on plan assets      | -                           | -                           |

**Note 19. Revenues**

|              | <b>Year ended<br/>31 December 2006</b> | <b>Year ended<br/>31 December 2005</b> |
|--------------|--|--|
| Electricity  | 24,821,685                             | 18,817,258                             |
| Heating      | 497,333                                | 419,501                                |
| Other        | 114,650                                | 159,794                                |
| <b>Total</b> | <b>25,433,668</b>                      | <b>19,396,553</b>                      |



**OGK-2 Group**

**Notes to the Combined and Consolidated Financial Statements for the years ended**

**31 December 2006 and 31 December 2005**

(in thousands of Russian Roubles)

**Note 20. Other operating income**

|                              | Year ended<br>31 December 2006 | Year ended<br>31 December 2005 |
|------------------------------|--------------------------------|--------------------------------|
| Tax penalties forgiveness    | -                              | 197,243                        |
| Prior periods taxes reversal | 212,971                        | 179,176                        |
| Other expenses               | (115,144)                      | (147,342)                      |
| <b>Total</b>                 | <b>97,827</b>                  | <b>229,077</b>                 |

**Note 21. Operating expenses (excluding reversal of impairment of property, plant and equipment)**

|  | Notes | Year ended<br>31 December 2006 | Year ended<br>31 December 2005 |
|--|-------|--------------------------------|--------------------------------|
| Fuel   |       | 16,303,527                     | 12,533,082                     |
| Employee benefits  |       | 2,084,073                      | 1,547,975                      |
| Repairs and maintenance  |       | 1,880,947                      | 2,100,638                      |
| Purchased electricity and heat   |       | 1,129,084                      | 7,054                          |
| Depreciation   | 6     | 855,823                        | 856,310                        |
| Taxes other than income tax  |       | 888,483                        | 774,878                        |
| Raw materials and supplies   |       | 793,205                        | 517,733                        |
| (Decrease)/ increase of provision for inventory obsolescence   |       | (51,589)                       | 10,764                         |
| Dispatcher's fees  |       | 438,610                        | -                              |
| Loss on disposal of property, plant and equipment  |       | 179,887                        | 30,508                         |
| Ecology payments   |       | 175,540                        | 30,415                         |
| Charge/(reversal) of impairment provision for accounts receivable  |       | 196,303                        | (74,735)                       |
| Consulting, legal and audit services   |       | 152,721                        | 113,636                        |
| Transport  |       | 124,183                        | 73,804                         |
| Leasing and rent   |       | 114,649                        | 31,390                         |
| Insurance  |       | 59,076                         | 84,144                         |
| Other expenses   |       | 857,183                        | 789,532                        |
| <b>Total operating expenses (excluding reversal of impairment of property, plant and equipment, net)</b> |       | <b>26,181,705</b>              | <b>19,427,128</b>              |

Employee benefits expenses comprise the following:

|   | Year ended<br>31 December 2006 | Year ended<br>31 December 2005 |
|---|--------------------------------|--------------------------------|
| Salaries and wages                              | 1,562,998                      | 1,164,447                      |
| Payroll taxes                                   | 301,405                        | 237,747                        |
| Non-state pensions and other long-term benefits | 108,523                        | 51,747                         |
| Financial aid to employees and pensioners       | 111,147                        | 94,034                         |
| <b>Employee benefits</b>                        | <b>2,084,073</b>               | <b>1,547,975</b>               |
| Number of personnel at the end of the period    | 5,073                          | 5,080                          |

**OGK-2 Group****Notes to the Combined and Consolidated Financial Statements for the years ended  
31 December 2006 and 31 December 2005**

(in thousands of Russian Roubles)

**Note 22. Finance costs**

|                           | Year ended<br>31 December 2006 | Year ended<br>31 December 2005 |
|---------------------------|--------------------------------|--------------------------------|
| Finance income            | (12,611)                       | (923)                          |
| Interest expense          | 222,464                        | 148,397                        |
| Finance lease charges     | 57,705                         | 38,921                         |
| <b>Total finance cost</b> | <b>267,558</b>                 | <b>186,395</b>                 |

**Note 23. Earnings per ordinary share for profit attributable to the shareholders of OJSC OGK-2 – basic and diluted (in RR)**

|  | Year ended<br>31 December 2006 | Year ended<br>31 December 2005 |
|--|--------------------------------|--------------------------------|
| Weighed average number of ordinary shares issued   | 26,480,895,818                 | 26,480,895,818                 |
| Profit attributable to the shareholders of OJSC OGK-2<br>(thousands of RR)*  | 2,566,548                      | 420,325                        |
| <b>Earnings per ordinary share for profit attributable to<br/>the shareholders of OJSC OGK-2 – basic and diluted<br/>(in RR)</b> | <b>0,097</b>                   | <b>0,02</b>                    |

\* weighted average number of shares was calculated as they always were in issue starting the first period presented.

**Note 24. Commitments**

**Sales commitments.** The Group's entities sell electricity on the 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.

The Group has not entered into sales agreements with duration of more than one year.

**Fuel commitments.** The Group has a number of outstanding contracts to purchase natural gas and coal, which are supplied under annual contracts. Part of the Group's gas supplies are provided on short-term basis from a variety of suppliers. Prices under the Group's natural gas and coal contracts are generally determined by reference to base amounts adjusted to reflect provisions for changes in regulatory prices, published inflation indices and current market prices.

**Capital commitments.** The Group has capital commitments of RR 403,401 thousand and RR 219,235 thousand as of 31 December 2006 and as of 31 December 2005, respectively. As at 31 December 2006 the Group has commitments of RR 191,000 thousands in respect of SAP R-3 implementation costs. Also, the Company is currently negotiating with environmental authorities new limits on contagious smokes for one of its plants. As a result of new limits approval the Company will be committed for capital expenditures of RR 495,000 thousands which are aimed to reduce smokes levels of the respective plant.

**Note 25. Contingencies**

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

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

**Legal proceedings.** Group entities are party to certain legal proceedings arising in the ordinary course of business. In the opinion of management, there are no current legal proceedings or other claims outstanding, which, upon final disposition, will have a material adverse effect on the position of the Group.

The Company entered into a joint and several liability agreement for the contingent liabilities of JSC Tumenenergo from which Surgutskaya GRES-1 power plant spun off. The agreement stipulates joint and several liability over the contingent liabilities of JSC Tumenenergo which can crystallise as a result of legal claim against JSC Tumenenergo in respect of events happened before the date of spun-off. Share of liability of the Company in case the liability arises equals 18.7%. The amount for which the Company could be liable is not reasonably assessable.

**Tax contingency.** Russian tax, currency and customs legislation is subject to varying interpretation, and changes, which can occur frequently. Management' interpretation of such legislation as applied to the transactions and activity of the Group may be challenged by the relevant regional and federal authorities. Recent events within the Russian Federation suggest that the tax authorities may be taking a more assertive position in their interpretation of the legislation and assessments, in particular, the way of accounting for tax purposes of tariff imbalance, water tax, and deductibility of some costs for income tax purposes and recoverability of input VAT associated with these costs. 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 proceeding the year of review. Under certain circumstances review may cover longer periods.

As at 31 December 2006, management believes that its interpretation of the relevant legislation is appropriate and the Group's tax, currency and customs positions will be sustained. Where management believes it is probable that a position cannot be sustained, an appropriate amount has been accrued for in these Financial Statements.

No disclosure has been made in respect of the possible financial effect of potential claims or disputes on some matters as this might seriously prejudice the position of the Group.

Due to the fact that the tax and other legislation do not fully cover all the aspects of the Group restructuring, there might be respective legal and tax risks.

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

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

#### **Note 26. Financial instruments and financial risks**

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

**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.

The cash has been deposited in the financial institutions with no more than minimal exposure to the default risk at the time of account opening.

**Interest rate risk.** The Group's operating profits and cash flows from operating activity are largely not dependent on the changes in market interest rates. The Group is only exposed to fair value interest rate risk as all of its borrowings are at fixed interest rates. The Group has no significant interest-bearing assets.

**Fair values.** Management believes that the fair value of its financial assets and liabilities approximates their carrying amount.

#### **Note 27. Post balance sheet events**

**Share option program.** In December 2006 the Board of directors of the Company approved share-option program. The employees of the Company will be granted the option to purchase the ordinary shares of the Company at average Russian Trading System (RTS) quotation during the period of 365 days (or minimum 6 months since start of trading) up to the grant date.

Percentage of shares participating in the share program is limited by 2% of total outstanding shares of the Company. The Company did not have signed share option contracts with its employees as at the date of these financial statements.

**Decrease of share capital.** On 1 March 2007 the shareholders of the Company approved decrease of share capital of the Company from RR 26,480,896 thousand to RR 9,604,620 thousands through decrease of nominal value of one share of the Company from RR 1 to RR 0.3627.

**Bonds issue.** On 21 March 2007 the Management Board of the Company approved issue of Company bonds for total amount of RR 5,000,000 thousand (5,000,000 bonds at par value of RR 1,000) with maturity of 1,096 days.

**Short-term loan facility with Sberbank.** In March 2007 the Company signed loan agreement with Sberbank on short-term unsecured financing facility with maximum amount of RR 300,000 thousand at 9.6% per annum to re-finance short-term loans.

**Long-term loan facility with Evrofinance Mosnarbank.** In April 2007 the Company received long-term loan facility from Evrofinance Mosnarbank of RR 1,200,000 to re-finance short-term loans. The facility matures on 15 September 2008. Interest rate is 10.5%.

**Dividends.** In June 2007 the Company declared dividends for 2006 of RR 0.001873 per share for the total amount of RR 49,599 thousand and interim dividends for three months ended 31 March 2007 of RR 0.0015257 per share for the total amount of RR 40,402 thousand. Those dividends were not recognized as a liability or deducted from equity at 31 December 2006.

**Share capital.** In June 2007 the Company authorised for issue 12,000,000,000 of ordinary shares with par value of RR 0.3627 each. It is expected that these shares will be placed through a public offering.