

**OJSC VOLGA TGC  
CONSOLIDATED INTERIM FINANCIAL STATEMENTS,  
PREPARED IN ACCORDANCE WITH INTERNATIONAL FINANCIAL  
REPORTING STANDARDS (IFRS) FOR THE NINE MONTHS  
ENDED 30 SEPTEMBER 2007**



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## **INDEPENDENT AUDITORS' REPORT ON REVIEW OF THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

To the Board of Directors of OJSC Volga TGC

### *Introduction*

We have reviewed the accompanying consolidated interim balance sheet of OJSC Volga TGC (the "Company") and its subsidiaries (the "Group") as of 30 September 2007 and the related consolidated interim statements of income, changes in equity and cash flows for the nine-month period ended 30 September 2007, and a summary of significant accounting policies and other explanatory notes (the consolidated interim financial statements). Management is responsible for the preparation and fair presentation of these consolidated interim financial statements in accordance with International Financial Reporting Standard IAS 34 *Interim Financial Reporting*. Our responsibility is to express a conclusion on these consolidated interim financial statements based on our review.

### *Scope of Review*

We conducted our review in accordance with International Standard on Review Engagements 2410 *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*. A review of interim financial statements consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

### *Conclusion*

Based on our review, nothing has come to our attention that causes us to believe that the consolidated interim financial statements do not present fairly, in all material respects, the consolidated interim financial position of the Group as of 30 September 2007, and its consolidated interim financial performance and its consolidated interim cash flows for the nine-month period then ended in accordance with International Financial Reporting Standard IAS 34 *Interim Financial Reporting*.

**ZAO KPMG**

ZAO KPMG  
26 December 2007

**OJSC Volga TGC**  
**Consolidated Interim Balance Sheet as at 30 September 2007 (unaudited)**  
(in thousands of Russian rubles unless otherwise noted)

	Notes	30 September 2007	31 December 2006
<b>ASSETS</b>			
<b>Non-current assets</b>			
Property, plant and equipment	5	34,693,154	35,012,992
Intangible assets	6	701,474	560,566
Deferred tax assets	21	184,057	474,003
Other non-current assets	7	428,559	572,562
Available-for-sale financial assets	8	158,506	365,616
<b>Total non-current assets</b>		<b>36,165,750</b>	<b>36,985,739</b>
<b>Current assets</b>			
Cash and cash equivalents	9	692,919	967,196
Advances to suppliers and prepayments		674,125	709,705
Accounts receivable	10	1,647,105	1,807,038
Income tax receivable		1,100,527	90,812
Value added tax recoverable		261,311	294,935
Available-for-sale financial assets	8	286,977	75,878
Inventories	11	2,818,523	2,693,645
<b>Total current assets</b>		<b>7,481,487</b>	<b>6,639,209</b>
<b>TOTAL ASSETS</b>		<b>43,647,237</b>	<b>43,624,948</b>
<b>EQUITY AND LIABILITIES</b>			
<b>Equity</b>			
Ordinary shares (nominal value RR 26,116,076 thousand)	12	26,116,076	26,116,076
Additional paid in capital	12	1,587,056	1,587,056
Retained earnings and other reserves		2,570,889	2,638,999
<b>Total equity</b>		<b>30,274,021</b>	<b>30,342,131</b>
<b>Non-current liabilities</b>			
Deferred tax liabilities	21	5,140,519	5,384,237
Finance lease liabilities	13	-	514
Promissory notes	14	144,243	220,780
Provisions for liabilities and charges	15	1,391,125	1,284,650
Other non-current liabilities		278	12
<b>Total non-current liabilities</b>		<b>6,676,165</b>	<b>6,890,193</b>
<b>Current liabilities</b>			
Loans and finance lease liabilities	13	4,162,682	2,885,052
Accounts payable and accrued charges	16	1,828,963	1,948,082
Income tax payable		-	177,776
Promissory notes	14	113,061	128,808
Provisions for liabilities and charges	15	18,223	29,020
Other taxes payable	17	574,122	1,223,886
<b>Total current liabilities</b>		<b>6,697,051</b>	<b>6,392,624</b>
<b>Total liabilities</b>		<b>13,373,216</b>	<b>13,282,817</b>
<b>TOTAL EQUITY AND LIABILITIES</b>		<b>43,647,237</b>	<b>43,624,948</b>

These consolidated interim financial statements were approved by the management of the Group on 26 December 2007 and were signed on its behalf by:

General Director

V.V. Nikonov

Chief Accountant

A.F. Varenov

The accompanying notes on pages 7 to 30 are an integral part of these consolidated interim financial statements.

**OJSC Volga TGC****Consolidated Interim Income Statement for the nine months ended 30 September 2007 (unaudited)**

(in thousands of Russian rubles unless otherwise noted)

	Note	Nine months ended 30 September 2007	Nine months ended 30 September 2006
Revenues	18	27,149,719	23,435,887
Operating expenses	19	(26,759,632)	(23,793,274)
<b>Operating profit/(loss)</b>		<b>390,087</b>	<b>(357,387)</b>
Other income		20,433	90,065
Net finance expense	20	(184,617)	(43,873)
<b>Profit/(loss) before income tax</b>		<b>225,903</b>	<b>(311,195)</b>
Income tax expense	21	(300,775)	(68,215)
<b>Net loss for the period</b>		<b>(74,872)</b>	<b>(379,410)</b>
Basic earnings per ordinary share in Russian rubles	22	(0.003)	(0.015)

The accompanying notes on pages 7 to 30 are an integral part of these consolidated interim financial statements.

**OJSC Volga TGC**  
**Consolidated Interim Statement of Cash Flows for the nine months ended 30 September 2007 (unaudited)**  
(in thousands of Russian rubles)

	Nine months ended 30 September 2007	Nine months ended 30 September 2006
<b>CASH FLOW FROM OPERATING ACTIVITIES</b>		
Profit/(loss) before income tax		
Adjustments for:	225,903	(311,195)
Depreciation		
Amortisation of intangible assets	1,938,475	1,777,162
Gain on disposal of property, plant and equipment	45,942	25,579
Increase in liability for defined benefit plans	(12,207)	(1,139)
Net finance expense	106,475	137,952
Reversal of impairment of accounts receivable	184,617	43,873
Reserve for obsolescence	(52,633)	(106,079)
Gain on sale of non-current assets held for sale	7,195	40,479
	-	(15,048)
<b>Operating cash flows before changes in working capital and profit tax paid</b>	<b>2,443,767</b>	<b>1,591,584</b>
Decrease/(increase) in trade and other receivables	527,802	(834,657)
Increase in inventories	(132,073)	(1,005,963)
Increase in other current assets	(89,737)	(121,785)
(Decrease)/increase in trade and other payables	(775,956)	1,034,477
Interest paid	(190,028)	(36,588)
Income tax paid	(1,441,320)	(664,662)
<b>Net cash from operating activities</b>	<b>342,455</b>	<b>(37,594)</b>
<b>CASH FLOW FROM INVESTING ACTIVITIES</b>		
Acquisition of property, plant and equipment	(1,606,505)	(1,143,714)
Acquisition of intangible assets and other non-current assets	(186,850)	(136,562)
Proceeds from sale of property, plant and equipment	35,265	3,500
Interest received	7,510	10,286
Acquisition of available-for-sale financial assets	(73,372)	-
Repayment of available-for-sale financial assets	93,978	105,405
Loans granted	(27,700)	-
Proceeds from sale of non-current assets held for sale	-	261,000
<b>Net cash used in investing activities</b>	<b>(1,757,674)</b>	<b>(900,085)</b>
<b>CASH FLOW FROM FINANCING ACTIVITIES</b>		
Proceeds from borrowings	10,956,800	3,223,601
Repayment of borrowings	(9,795,900)	(2,048,627)
Payment of finance lease liabilities	(5,308)	(5,627)
Dividends paid	(14,650)	(31,024)
<b>Net cash from financing activities</b>	<b>1,140,942</b>	<b>1,138,323</b>
<b>(Decrease)/ increase in cash and cash equivalents</b>	<b>(274,277)</b>	<b>200,644</b>
<b>Cash at the beginning of the period</b>	<b>967,196</b>	<b>340,802</b>
<b>Cash at the end of the period</b>	<b>692,919</b>	<b>541,446</b>

The accompanying notes on pages 7 to 30 are an integral part of these consolidated interim financial statements.

**OJSC Volga TGC**  
**Consolidated Interim Statement of Changes in Equity for the nine months ended 30 September 2007**  
**(unaudited)**  
(in thousands of Russian rubles)

	Share capital	Additional paid in capital	Available-for-sale financial assets revaluation reserve	Retained earnings	Total equity
<b>Balance as at 1 January 2006</b>	26,116,076	1,587,056	(98,600)	2,590,473	30,195,005
Changes in fair value of available-for-sale financial assets	-	-	28,773	-	28,773
Net profit recognized directly in equity	-	-	28,773	-	28,773
Net loss for the period	-	-	-	(379,410)	(379,410)
Total recognized loss for the period	-	-	28,773	(379,410)	(350,637)
Dividends	-	-	-	(35,903)	(35,903)
<b>Balance as at 30 September 2006</b>	26,116,076	1,587,056	(69,827)	2,175,160	29,808,465
<b>Balance as at 1 January 2007</b>	26,116,076	1,587,056	(59,798)	2,698,797	30,342,131
Changes in fair value of available-for-sale financial assets	-	-	21,412	-	21,412
Net profit recognized directly in equity	-	-	21,412	-	21,412
Net loss for the period	-	-	-	(74,872)	(74,872)
Total recognized loss for the period	-	-	21,412	(74,872)	(53,460)
Dividends	-	-	-	(14,650)	(14,650)
<b>Balance as at 30 September 2007</b>	26,116,076	1,587,056	(38,386)	2,609,275	30,274,021

The accompanying notes on pages 7 to 30 are an integral part of these consolidated interim financial statements.

## **OJSC Volga TGC**

**Notes to the Consolidated Interim Financial Statements for the nine months ended 30 September 2007**

**(unaudited)**

(in thousands of Russian rubles)

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

Open Joint Stock Company Volga Territorial Generating Company, (OJSC Volga TGC, or the "Company"), was established on August 1, 2005, within the framework of Russian electricity sector restructuring in accordance with the Resolution of General Shareholders Meetings by OJSC Samaraenergo, OJSC Saratovenergo and OJSC Ulyanovskenergo, the companies ultimately controlled by RAO UES of Russia.

On 1 April 2006 in accordance with the Resolution of General Shareholders Meetings on reorganization in the form of regional generation companies spin-off the following legal entities were spun off from OJSC Samaraenergo, OJSC Saratovenergo and OJSC Ulyanovskenergo: OJSC Samara Territorial Generating Company, OJSC Saratov Territorial Generating Company and OJSC Ulyanovsk Territorial Generating Company, which became the shareholders of the Company.

On 3 July 2007 the final stage of the Company's formation was completed by merging OJSC Samara Territorial Generating Company, OJSC Saratov Territorial Generating Company and OJSC Ulyanovsk Territorial Generating Company into the Company. Their respective shares were transferred to RAO UES of Russia, who became the direct controlling shareholder of the Company.

The Group Volga TGC (the "Group") comprises 17 thermoelectric power stations, 5 heat networks and 2 regional state power stations. The Group consists of OJSC Volga TGC and 3 subsidiaries. The Group's major subsidiary is Open Joint Stock Company Orenburg Heat Generating Company (hereinafter Orenburg TGC).

The Group's principle activity is electricity and heat generation.

The Company's registered office is 15, Mayakovskogo str., 443100, Samara, Russia.

#### **Russian business environment**

The Russian Federation has been experiencing political and economic change that has affected, and may continue to affect, the activities of enterprises operating in this environment. Consequently, operations in the Russian Federation involve risks that typically do not exist in other markets. The consolidated interim financial statements reflect management's assessment of the impact of the Russian business environment on the operations and the financial position of the Group. The future business environment may differ from management's assessment.

#### **Relations with the state and regulation of the Group**

As at 30 September 2007 the following shareholders owned OJSC Volga TGC: RAO UES of Russia (54%), CJSC Deposit-clearing company (33%), other minority shareholders (13%). RAO UES of Russia ("the Parent") is the controlling shareholder of the Group. As at 30 September 2007 the Government of the Russian Federation owned 52.7% of RAO UES of Russia.

Among the consumers of electricity and heat power of the Group are key entities controlled by, or related to, the state. Furthermore, the state controls a number of the Group's fuel and other suppliers (see Note 23).

The government of the Russian Federation directly affects the Group's operations through regulation by the Federal Service on Tariffs ("FST"), with respect to its wholesale energy sales, and by the regional services on tariffs ("RSTs"), with respect to its retail electricity and 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 of Russia.

Tariffs which Group may charge for sales of electricity and heat are governed both by regulations specific to the electricity and heat industry and by regulations applicable to natural monopolies. As a condition to privatization in 1992, the government of the Russian Federation imposed an obligation on RAO UES entities to provide connection for the supply of electricity and heating to customers in the Russian Federation.

**Note 1. The Group and its operations (continued)**

**Sector restructuring**

The Russian electric utilities industry in general and the Group in particular are presently undergoing a reform process designed to introduce competition into the electricity sector and to create an environment in which the Group 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 volumes of electricity (power) traded in the wholesale market at regulated prices began to reduce. The pace of reduction is set by the Russian Federation Government according to socio-economic development forecasts. In 2007 up to 90% of the forecasted production volumes is traded at regulated prices. In 2013 it will become possible to launch a fully competitive whole sale market.

As at 29 May 2003, the Board of Directors of RAO UES approved a "Concept of RAO UES strategy for the period from 2003 through 2008" (further- the "Concept of RAO UES Strategy"). In February 2006 the Board of Directors approved Appendixes to the Concept of RAO UES Strategy: "Territorial generating companies ("TGCs") being created on the basis of assets of the Holding Group RAO UES" and "Generating companies of the Wholesale Electricity Market ("WGCs")". These documents provide a detailed description of the major changes that are planned to take place during the electric utilities reform program.

At present, the impact of the industry changes on both the financial results and position of the Group cannot be readily assessed. Accordingly, no provisions has been recognized for the effect of restructuring process.

Management believes that as an ultimate result, a stable regulatory regime and a competitive power market will be established, what will allow Group to raise funds for developing its business. However, there can be no complete assurance in this regard.

**Restructuring of the Group**

Upon the formation of the Company, as described above, in August 2005, the founders transferred the ownership of their heat and electricity generating assets as the initial contribution to the Company's share capital. These assets were subsequently leased back to the original owners until the Company's own generating activities commenced on 1 January 2006.

In April 2007, the Parent transferred 100% of the shares of Orenburg TGC to the Company in exchange for additional shares issued by the Company solely for this purpose as part of the overall restructuring of the Group (see Note 12).

All assets and activities contributed to the group as part of the restructuring are transferred from entities under common control of RAO UES of Russia.

In accordance with its accounting policy, the Group presented consolidated interim income statement, statements of changes in equity and cash flows as if the restructuring described above had been completed prior to 2006

**Note 2. Financial conditions**

As discussed above the Group is affected by the Government through control of tariffs and other factors. The FST and RSTs do not always permit tariff increases in line with increases in the Group's costs and thus some tariffs are insufficient to cover all the costs of generation and distribution. Moreover, these tariffs consider costs only on the Russian statutory basis and, accordingly, exclude additional costs recognized under the International Financial Reporting Standards ("IFRS"). 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, in 2006 and to date in 2007, the growing demand for electricity and capacity together with increasing free trading sector of the wholesale electricity market have resulted in a higher rate of revenue growth (see Sector restructuring in Note 1).



**Note 2. Financial conditions (continued)**

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

- introduction of improved financial budgeting procedures;
- force concentration on timely cash collection of current and expired accounts receivable;
- negotiations with strategic investors, identification and assessment of projects requiring financial investments;
- negotiations with federal and regional governments and regulators concerning the increases in tariffs to support adequate long term investment into the Group's generation assets;

**Note 3. Basic approaches for financial statements preparation**

***Statement of compliance***

These consolidated interim financial statements have been prepared in accordance with International Financial Reporting Standard ("IFRS") (IAS) 34 *Interim Financial Reporting*. The entities that constitute the restructured group, as discussed in Note 1, adopted IFRS as at 1 January 2005.

***Basis of measurement***

The consolidated interim financial statements are prepared on the historical cost basis except that financial investments classified as available-for-sale are stated at fair value; property, plant and equipment was revalued to determine deemed cost as part of the adoption of IFRSs.

***Functional and presentation currency***

The national currency of the Russian Federation is the Russian ruble ("RUR"), which is the Group's functional currency and the currency in which these consolidated interim financial statements are presented. All financial information presented in Russian rubles has been rounded to the nearest thousand.

***Use of judgments, estimates and assumptions***

Management has made a number of judgments, estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare these consolidated financial statements in conformity with IFRSs. Actual results may differ from those estimates. Judgments and estimates that have the most significant effect on the amounts recognised in the financial statements include:

***Impairment provision for accounts receivable***

Management has determined the provision for impairment of receivables based on specific customer identification, payment trends and subsequent receipts in order to estimate the fair value of future cash collections. Management believes that the Group will be able to realize the net receivable amount through direct collections and other non-cash settlements and that therefore the recorded value approximates their fair value (see Note 10).

***Property, plant and equipment***

Fair value of property, plant and equipment as at 1 January 2005 has been determined by an independent appraiser based on the depreciated replacement cost method as well as estimated income. As described in Note 5 the determination of fair value is based on management assessment of future growth in sales and production. Further, management assesses the useful lives of property, plant and equipment based upon experience with similar assets. In determining the useful life of an asset, management considers the expected usage, estimated technical obsolescence, physical wear and tear and the physical environment in which the asset is operated. Carrying value and depreciation of property, plant and equipment are significantly affected by the above estimates, and actual results may differ from those estimates. Any changes to these estimates may have significantly impact on these consolidated financial statements.

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

##### **4.1 Basis of consolidation**

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

##### ***Subsidiaries***

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account.

##### ***Transactions among entities under common control***

Transfers of interests in entities that are under the control of the shareholder that controls the Company are accounted for as if the transfer had occurred at the beginning of the earliest comparative period presented. For this purpose the assets and liabilities are recognized at their carrying amounts and comparatives are restated. The entities constituting the restructured Group do not prepare individual financial statements under IFRSs. For the purpose of preparing these consolidated financial statements, the Group applied the provisions in IFRS 1 First-time Adoption of IFRS. As a result, property, plant and equipment were revalued as of 1 January 2005 to determine deemed cost as part of the adoption of IFRSs. Any difference between the carrying amount of transferred net assets and cost of investment is accounted for as an adjustment to equity.

##### ***Associates***

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

##### ***Transactions eliminated on consolidation***

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

##### **4.2 Foreign currency**

Transactions in foreign currencies are translated to Russian rubles at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to Russian rubles at the exchange rate at that date. Non-monetary assets and liabilities that are measured at fair value in a foreign currency are translated to Russian rubles at the exchange rate at the date that the fair value was determined. Foreign currency differences arising on retranslation are recognised in profit or loss, except for differences arising on the retranslation of available-for-sale equity instruments.

**Note 4. Summary of significant accounting policies (continued)**

**4.3 Non-derivative financial instruments**

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

Non-derivative financial instruments are recognised initially at fair value plus, for instruments not at fair value through profit or loss, any directly attributable transaction costs, except as described below. Subsequent to initial recognition non-derivative financial instruments are measured as described below.

A financial instrument is recognised if the Group becomes a party to the contractual provisions of the instrument. Financial assets are derecognised if the Group's contractual rights to the cash flows from the financial assets expire or if the Group transfers the financial asset to another party without retaining control or substantially all risks and rewards of the asset. Financial liabilities are derecognised if the Group's obligations specified in the contract expire or are discharged or cancelled.

Cash comprises cash in hand and cash deposited on demand at banks. Cash equivalents comprise short-term high 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.

***Held-to-maturity investments***

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

***Available-for-sale financial assets***

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

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

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

***Investments at fair value through profit or loss***

An instrument is classified as at fair value through profit or loss if it is held for trading or is designated as such upon initial recognition. Financial instruments are designated at fair value through profit or loss if the Group manages such investments and makes purchase and sale decisions based on their fair value. Upon initial recognition, attributable transaction costs are recognised in profit or loss when incurred. Financial instruments at fair value through profit or loss are measured at fair value, and changes therein are recognised in profit or loss.

***Other***

Other non-derivative financial instruments are measured at amortised cost using the effective interest method, less any impairment losses. Investments in equity securities that are not quoted on a stock exchange and where fair value cannot be estimated on a reasonable basis by other means are stated at cost less impairment losses.

**Note 4. Summary of significant accounting policies (continued)**

**4.3 Non-derivative financial instruments (continued)**

***Fair value disclosure***

Fair value, which is determined for disclosure purposes, is calculated based on the present value of future principle and interest cash flows, discounted at the market rate of interest at the reporting date. For finance leases the market rate of interest is determined by reference to similar lease agreements.

**4.4 Property, plant and equipment**

***Recognition and measurement***

Items of property, plant and equipment, except for land, are measured at cost less accumulated depreciation and impairment losses. The cost of property, plant and equipment at 1 January 2005, the date of transition to IFRSs, was determined by reference to its fair value at that date ("deemed cost").

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

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

***Subsequent costs***

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

***Depreciation***

Depreciation is recognised in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. For the property, plant and equipment which were subject to the independent appraiser as at 1 January 2005, the applied depreciation rate is based on the estimated remaining useful lives as at the valuation date. The useful lives, in years, of property, plant and equipment by type of facility are present as follows:

<b>Type of property, plant and equipment</b>	<b>Useful lives (in years)</b>
Electricity and heat generation	10-30
Heating networks	7-10
Other	3-30

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

##### 4.5 Intangible assets

###### *Research and development*

Expenditure on research activities, undertaken with the prospect of gaining new technical knowledge and understanding, is recognized in profit or loss when incurred.

Development activities involve a plan or design for the production of new or substantially improved products and processes. Development expenditure is capitalized only if development costs can be measured reliably, the product or process is technically and commercially feasible, future economic benefits are probable, and the Group intends to and has sufficient resources to complete development and to use or sell the asset. The expenditure capitalized includes the cost of materials, direct labour and overhead costs that are directly attributable to preparing the asset for its intended use. Other development expenditure is recognized in profit or loss when incurred.

Capitalized development expenditure is measured at cost less accumulated amortization and accumulated impairment losses.

###### *Other intangible assets*

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

###### *Subsequent expenditure*

Subsequent expenditure is capitalized only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure, including expenditure on internally generated goodwill and brands, is recognized in profit or loss when incurred.

###### *Amortization*

Amortization is recognized in profit or loss on a straight-line basis over the estimated useful lives of intangible assets from the date that they are available for use. The estimated useful lives for the current and comparative periods are as follows:

Type of intangible assets	Useful lives (in years)
Computer software	3-10
Licenses	2-5
Capitalised development costs	2-5

##### 4.6 Leased assets

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

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

##### 4.7 Inventories

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

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

##### 4.8 Impairment

###### *Financial assets*

A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

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

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

All impairment losses are recognised in profit or loss. Any cumulative loss in respect of an available-for-sale financial asset recognised previously in equity is transferred to profit or loss.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognised. For financial assets measured at amortised cost and available-for-sale financial assets that are debt securities, the reversal is recognised in profit or loss. For available-for-sale financial assets that are equity securities, the reversal is recognised directly in equity.

###### *Non-financial assets*

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

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

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

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

##### 4.9 Employee benefits

###### *Defined contribution plans*

In the normal course of business the Group contributes all obligatory payments to the Russian Federation state pension fund on behalf of its employees. Mandatory contributions to the governmental pension scheme are expensed when incurred and recognized in the Income statements as employee benefit expenses and payroll taxes.

###### *Defined benefit plans and other long-term employee benefits*

The Group's net obligation in respect of defined benefit pension plans is calculated separately for each plan by estimating the amount of future benefit that employees have earned in return for their service in

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

##### 4.9 Employee benefits (continued)

the current and prior periods; that benefit is discounted to determine its present value, and any unrecognised past service costs and the fair value of any plan assets are deducted. The discount rate is the yield at the reporting date on government bonds that have maturity dates approximating the terms of the Group's obligations. The calculation is performed by a qualified actuary using the projected unit credit method. When the benefits of a plan are improved, the portion of the increased benefit relating to past service by employees is recognised in profit or loss on a straight-line basis over the average period until the benefits become vested. To the extent that the benefits vest immediately, the expense is recognised immediately in profit or loss.

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

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

##### 4.10 Environmental liabilities

Liabilities for environmental remediation are recorded in accounting in the presence of such obligations, when the payment is probable and reliable estimates exist.

##### 4.11 Non-current assets classified as held for sale

Non-current assets or disposal groups are classified in the balance sheet as held for sale when their carrying amount will be recovered principally through a sale transaction and not through their use.

Assets (disposal groups) are classified as held for sale when they can be sold in their present condition and on the terms that are typical for such assets and such sale in itself needs to be highly probable.

Sale can be characterized as highly probable when the management has a firm intention to dispose of the asset, actively searches for potential buyers, has a plan of the asset disposal and works on its execution. An asset becomes a marketable asset for sale at a price comparable to its fair value.

Held for sale assets are measured at the lower of their carrying amount and fair value less costs to sell. Any impairment loss on a disposal group first is allocated to goodwill, and then to remaining assets and liabilities on pro rata basis, except that no loss is allocated to inventories, financial assets, deferred tax assets, employee benefit assets, which continue to be measured in accordance with the Group's accounting policy. Impairment losses on initial classification as held for sale and subsequent gains and losses on remeasurement are recognized in the consolidated statement of income. Gains are not recognized in excess of any cumulative impairment loss. Held for sale assets (or disposal groups) are not depreciated or amortised.

##### 4.12 Revenue

Revenue is recognized when the significant risks and rewards of ownership have been transferred to the buyer of electricity and heat or non-utility goods and services.

Revenue is measured at the fair value of the consideration received or receivable. When the fair value of consideration received cannot be measured reliably, the revenue is measured at the fair value of the goods or services sold/provided. Revenue is stated net of value added tax.

**Note 4. Summary of significant accounting policies (continued)**

**4.13 Lease payments**

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

Minimum lease payments made under finance leases are apportioned between the finance expense and the reduction of the outstanding liability. The finance expense is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability. Contingent lease payments are accounted for by revising the minimum lease payments over the remaining term of the lease when the lease adjustment is confirmed.

**4.14 Social expenditure**

To the extent that the Group's contributions to social programs benefit the community at large and are not restricted to the Group's employees, they are recognized in profit or loss as incurred.

**4.15 Finance income and expense**

Finance income comprises interest income on funds invested, gains on the disposal of available-for-sale financial assets and foreign currency gains. Interest income is recognised as it accrues, using the effective interest method.

Finance expenses comprise interest expense on borrowings, losses on the disposal of available-for-sale financial assets and foreign currency losses. All borrowing costs are recognised in profit or loss using the effective interest method.

**4.16 Income tax expense**

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

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

Deferred tax is recognised using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for the following temporary differences: the initial recognition of goodwill, the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit, and differences relating to investments in subsidiaries to the extent that they probably will not reverse in the foreseeable future. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

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

**4.17 Dividends**

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

**4.18 Earnings per share**

Basic earnings per share is determined by dividing the profit attributable to ordinary shareholders of the



**Note 4. Summary of significant accounting policies (continued)**

**4.18 Earnings per share (continued)**

Company by the weighted average number of ordinary shares in circulation during the reporting period, less the average number of treasury shares held by the Group.

**4.19 Treasury shares**

Treasury shares are stated at weighted average cost. The gains or losses arising on the disposal of treasury shares are recorded directly in equity. The Company has not issued any dilutive instruments.

**4.20 Segment reporting**

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

**4.21 New accounting developments**

The Group has adopted all IFRS, amendments and interpretations which are effective 1 January 2007 and which are relevant to its operations.

- IFRS 7 *Financial Instruments: Disclosures*, which is effective for annual periods beginning on or after 1 January 2007. As the application of the Standard only affects disclosure requirements, it did not have an impact on Group's results of operations, financial position or cash flows.
- Amendment to IAS 1 *Presentation of Financial Statements – Capital Disclosures*, which is effective for annual periods beginning on or after 1 January 2007. As the amendment of the Standard only affects disclosure requirements, it did not have an impact on Group's results of operations, financial position or cash flows.

A number of new Standards, amendments to Standards and Interpretations are not yet effective as at 30 September 2007, and have not been applied in preparing these consolidated interim financial statements.

- IFRS 8 *Operating Segments*, which is effective for annual periods beginning on or after 1 January 2009. The Standard introduces the "management approach" to segment reporting.
- IFRIC 12 *Service Concession Arrangements*, which is effective for annual periods beginning on or after 1 January 2008. The Interpretation addresses how service concession operators should account for the obligations they undertake and rights they receive in service concession arrangements.
- IFRIC 13 *Customer Loyalty Programmes*, which is effective for annual periods beginning on or after 1 July 2008. The Interpretation addresses the accounting for customer loyalty award credits by the grantor, including credit card providers.
- IFRIC 14 *IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements*, which is effective for annual periods beginning on or after 1 January 2008. The Interpretation addresses the defined benefit pension assets and their minimum funding requirements.
- IAS 23 *Borrowing costs*. The amendment is applied to borrowing costs, directly attributable to qualifying assets, which date of capitalization is annual periods beginning on or after 1 January 2009. The amendment excluded approach to recognize borrowing costs, directly attributable to qualifying assets, as expenses in the period in which it occurs.

The Group has not yet analysed the likely impact of the abovementioned Standards and Interpretations on its financial position or performance.

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**Note 5. Property, plant and equipment**

	Electricity and heat generation	Heating networks	Construction- in-progress, including advances	Other	Total
<b>Cost/Deemed cost</b>					
Balance at 1 January 2007	31,078,672	7,009,959	982,218	672,352	39,743,201
Additions	4,606	1,641	1,622,080	43,429	1,671,756
Transfers	316,857	31,383	(351,278)	3,038	-
Disposals	(14,130)	(14,742)	(11,710)	(92,026)	(132,608)
Balance at 30 September 2007	31,386,005	7,028,241	2,241,310	626,793	41,282,349
<b>Depreciation</b>					
Balance at 1 January 2007	(3,188,044)	(1,371,404)	-	(170,761)	(4,730,209)
Depreciation for the period	(1,301,152)	(549,012)	-	(88,311)	(1,938,475)
Disposals	3,926	8,367	-	67,196	79,489
Balance at 30 September 2007	(4,485,270)	(1,912,049)	-	(191,876)	(6,589,195)
<b>Carrying amounts</b>					
At 1 January 2007	27,890,628	5,638,555	982,218	501,591	35,012,992
At 30 September 2007	26,900,735	5,116,192	2,241,310	434,917	34,693,154
	Electricity and heat generation	Heating networks	Construction- in-progress, including advances	Other	Total
<b>Cost/Deemed cost</b>					
Balance at 1 January 2006	29,647,303	6,583,210	1,068,524	512,716	37,811,753
Additions	79,636	5,250	1,044,120	23,748	1,152,754
Transfers	228,464	2,994	(253,620)	22,162	-
Disposals	(10,937)	-	(272)	(5,407)	(16,616)
Balance at 30 September 2006	29,944,466	6,591,454	1,858,752	553,219	38,947,891
<b>Depreciation</b>					
Balance at 1 January 2006	(1,507,167)	(660,047)	-	(94,470)	(2,261,684)
Depreciation for the period	(1,215,729)	(504,622)	-	(56,811)	(1,777,162)
Disposals	2,507	-	-	2,717	5,224
Balance at 30 September 2006	(2,720,389)	(1,164,669)	-	(148,564)	(4,033,622)
<b>Carrying amounts</b>					
At 1 January 2006	28,140,136	5,923,163	1,068,524	418,246	35,550,069
At 30 September 2006	27,224,077	5,426,785	1,858,752	404,655	34,914,269

At 30 September 2007 construction in progress includes advance prepayments for property, plant and equipment of RR 217,152 thousand (31 December 2006: RR 72,996 thousand).

**Determination of deemed cost**

Management commissioned Institute of proprietorship problems to independently appraise property, plant and equipment as at 1 January 2005 in order to determine its deemed cost on the date of the Group's adoption of IFRSs. The fair value of property, plant and equipment was determined to equal RUR 35,649,727 thousand. As a result of revaluation the Group's equity increased by RR 6,720,677 thousand, the surplus in property, plant and equipment balance value is RR 8,842,996 thousand, less deferred tax liability in the amount of RR 2,122,319 thousand.

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**Note 5. Property, plant and equipment (continued)**

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

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

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

In addition to the determination of the depreciated replacement cost, cash flow testing was conducted in order to assess the reasonableness of those values, which resulted in the depreciated replacement cost values being decreased by RUR 68,950,000 thousand in arriving at the above value.

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

- Cash flows were projected based on actual operating results, EIU (The Economist Intelligence Unit) research, data produced by the Federal State Statistics Service (Rosstat) and forecasts of the Ministry for Economic Development and Trade of the Russian Federation.
- The anticipated annual production growth included in the cash flow projections was between 3% to 41% for the years 2007 to 2011.
- Cash flows for a further five years were extrapolated assuming no further growth of production.
- A discount rate of 11.48%-13.4% was applied in determining the recoverable amount of property, plant and equipment. The discount rate was estimated based on an industry average weighted average cost of capital.

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

**Note 6. Intangible assets**

Cost	Computer software	Licenses	Development costs	Total
Balance at 1 January 2007	281,395	766	318,264	600,425
Additions	46,931	3,638	136,280	186,849
Disposals	(23)	-	-	(23)
Balance at 30 September 2007	328,303	4,404	454,544	787,251
<b>Amortisation</b>				
Balance at 1 January 2007	-	-	-	-
Amortisation for the period	(35,906)	(172)	(3,781)	(39,859)
Amortisation disposal in the period	(33,579)	(269)	(12,093)	(45,941)
Balance at 30 September 2007	23	-	-	23
	(69,462)	(441)	(15,874)	(85,777)
<b>Carrying amounts</b>				
At 1 January 2007	-	-	-	-
At 30 September 2007	245,489	594	314,483	560,566
	258,841	3,963	438,670	701,474

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**Note 6. Intangible assets (continued)**

Cost	Computer software	Licenses	Development costs	Total
Balance at 1 January 2006	172,233	162	22,735	195,130
Additions	100,095	598	47,783	148,476
Disposals	(90)	-	-	(90)
Balance at 30 September 2006	272,238	760	70,518	343,516
<b>Amortisation</b>				
Balance at 1 January 2006	(2,786)	(12)	-	(2,798)
Amortisation for the period	(22,869)	(99)	(2,611)	(25,579)
Amortisation disposal in the period	90	-	-	90
Balance at 30 September 2006	(25,565)	(111)	(2,611)	(28,287)
<b>Carrying amounts</b>				
At 1 January 2006	169,447	150	22,735	192,332
At 30 September 2006	246,673	649	67,907	315,229

Development costs represent the implementation of SAP R3 software.

**Note 7. Other non-current assets**

	30 September 2007	31 December 2006
Restructured trade receivables (Note 10)	213,754	250,112
Trade and other receivables	16,552	145,432
Provision for impairment of accounts receivable	-	(47,902)
Advances for implementation of SAP R3 software	74,969	110,158
Long-term VAT recoverable	13,174	66,762
Loans granted	27,700	-
Other	82,410	48,000
<b>Total</b>	<b>428,559</b>	<b>572,562</b>

**Note 8. Available-for-sale financial assets**

	30 September 2007	31 December 2006
<b>Non-current investments</b>		
Bank promissory notes	158,506	365,616
<b>Total</b>	<b>158,506</b>	<b>365,616</b>
<b>Current investments</b>		
Bank promissory notes	286,977	75,878
<b>Total</b>	<b>286,977</b>	<b>75,878</b>

The fair value of available-for-sale investments with a carrying amount of RR 445,483 thousand as at 30 September 2007 (31 December 2006: RR 398,630 thousand) was determined by using 6.3-8.9% (31 December 2006: 8.7-9.4%) discount rate and with reference to their maturity. The nominal value of these interest free promissory notes is RR 483,869 thousand (31 December 2006: RR 458,431 thousand).

**Note 9. Cash and cash equivalents**

	30 September 2007	31 December 2006
Petty cash		
Bank balances	288	79
<b>Total</b>	<b>692,631</b>	<b>967,117</b>
	<b>692,919</b>	<b>967,196</b>

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**Note 9. Cash and cash equivalents (continued)**

Balance of cash and cash equivalents as of 30 September 2007 includes short-term bank deposit in the amount of RR 100,000 thousand. Deposits were placed with bank OAO KB Agroimpuls (Orenburg branch) for 1 month and had weighted average interest rate of 7 % per annum.

**Note 10. Accounts receivable**

	<b>30 September 2007</b>	<b>31 December 2006</b>
Trade receivables	2,819,378	3,102,318
Restructured accounts receivable	92,727	45,674
Tax prepayments	95,514	37,153
Other receivables	217,625	204,763
Provision for impairment of accounts receivable	(1,578,139)	(1,582,870)
<b>Total</b>	<b>1,647,105</b>	<b>1,807,038</b>

Certain trade receivables have been restructured and as a result are due to be realised more than one year from the balance sheet date (see Note 7). Expected future principle and interest cash flows from these receivables were discounted at 10.13%. The effect of discounting is included in net finance expenses (see Note 20).

**Impairment losses**

The aging of trade and other receivables at the reporting date was:

	<b>Gross impairment</b>		<b>Gross impairment</b>	
	<b>2007</b>	<b>2007</b>	<b>2006</b>	<b>2006</b>
Not past due	1,129,293	-	1,588,402	-
Past due 0-45 days	227,623	-	32,019	-
Past due 46-90 days	155,420	-	103,790	-
More than 90 days	1,617,394	1,578,139	1,628,544	1,582,870
<b>Total</b>	<b>3,129,730</b>	<b>1,578,139</b>	<b>3,352,755</b>	<b>1,582,870</b>

The movements in the allowance for impairment in respect of long-term and short-term trade and other receivables during the period was as follows:

	<b>30 September 2007</b>	<b>31 December 2006</b>
Balance at 1 January	1,630,772	1,779,104
Impairment loss reversed	(52,633)	(148,332)
<b>Balance at the end of the period</b>	<b>1,578,139</b>	<b>1,630,772</b>

Based on historic default rates, the Group believes that no impairment allowance is necessary in respect of receivables not past due or past due by up to 90 days.

**Note 11. Inventories**

	<b>30 September 2007</b>	<b>31 December 2006</b>
Fuel supplies	1,631,820	1,697,816
Raw materials and supplies	758,825	620,261
Spare parts	489,764	432,845
Other	10,764	8,178
Reserve for obsolescence	(72,650)	(65,455)
<b>Total</b>	<b>2,818,523</b>	<b>2,693,645</b>

At 30 September 2007 and 31 December 2006 inventories with a carrying amount of RR 959,487 thousand where pledged as collateral for bank loans (see Note 13).

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**Note 12. Equity**

	30 September 2007	31 December 2006
Ordinary shares	26,116,076,165	26,116,076,165
Par value (in RUR)	1.00	1.00

The charter capital of the Company formed upon its foundation was RR 22,830,000 thousand and consisted of 22,830,000,000 ordinary shares with nominal value of 1 ruble each.

In July 2007 the Company registered the results of 23,426,150,308 ordinary shares issue which were placed by conversion upon merger of regional generation companies (see Note 1).

In April 2007 the Company issued 2,689,925,857 additional ordinary shares with a par value of RR 1.00, which were placed by close subscription to the Parent. In payment for this additional share the Company received 100% of shares of Orenburg TGC. The fair value of shares of Orenburg TGC in the amount of RR 4,276,982 thousand was determined by independent appraiser. The amount in excess of par value is accounted for as additional paid in capital.

The shares were issued as part of the restructuring and therefore share capital for 2006 is RR 26,116,076 thousand.

**Dividends**

The Annual General Meeting of the shareholders on 29 May 2007 approved dividends on ordinary shares in respect of the year ended 31 December 2006 in the amount of 0.0030878 Russian rubles per share for the amount of RR 14,650 thousand. The dividends were paid in May 2007.

**Note 13. Loans and finance lease liabilities**

	30 September 2007	31 December 2006
<b>Non-current</b>		
Finance lease liabilities	-	514
<b>Total</b>	-	514
<b>Current</b>		
Secured bank loans		
Unsecured bank loans	3,111,331	1,630,400
Finance lease liabilities	1,051,351	1,253,550
<b>Total</b>	-	1,102
	<b>4,162,682</b>	<b>2,885,052</b>

	Currency	Interest rate	Year of maturity	30 September 2007	31 December 2006
Secured bank loans	RUR	Mosprime+3%	2008	2,854,531	-
Secured bank loans	RUR	11%	2008	256,800	-
Secured bank loans	RUR	Mosprime+3%	2007	-	1,500,000
Secured bank loans	RUR	12%	2007	-	130,400
Unsecured bank loans	RUR	11%-14.6%	2008	1,051,351	-
Unsecured bank loans	RUR	9.46%-9.72%	2007	-	1,200,000
Unsecured bank loans	RUR	13.2%	2006-2007	-	3,550
Unsecured bank loans	RUR	12%	2007	-	50,000
<b>Total</b>				<b>4,162,682</b>	<b>2,883,950</b>

The bank loans in the amount of RR 2,604,048 thousand (31 December 2006: RR 1,500,000 thousand) are secured over inventories in the amount of RR 959,487 thousand (see Note 11).

The bank loans in the amount of RR 507,283 thousand (31 December 2006: RR 130,400 thousand) are secured by cash flows on certain power supply contracts.

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**Note 14. Promissory notes**

	30 September 2007	31 December 2006
<b>Non-current</b>		
Long-term promissory notes	257,304	295,143
Current portion of long-term promissory notes	(113,061)	(74,363)
<b>Total</b>	<b>144,243</b>	<b>220,780</b>
<b>Current</b>		
Current portion of long-term promissory notes	113,061	74,363
Short-term promissory notes	-	54,445
<b>Total</b>	<b>113,061</b>	<b>128,808</b>

	30 September 2007	31 December 2006
<b>Due for repayment</b>		
Between one and two years	111,481	213,409
Between two and five years	32,762	7,371
<b>Total</b>	<b>144,243</b>	<b>220,780</b>

	Currency	Year of maturity	30 September 2007	31 December 2006
Promissory notes	RUR	2007	19,229	115,113
Promissory notes	RUR	2008	120,777	120,777
Promissory notes	RUR	2009	110,693	110,693
Promissory notes	RUR	2010	6,605	6,605
<b>Total</b>			<b>257,304</b>	<b>349,588</b>

Promissory notes with the carrying value of RR 255,321 thousand as at 30 September 2007 (31 December 2006: RR 347,605 thousand) represent promissory notes issued by the Group in 2005 to OAO Mezhtopenenergobank. The nominal value of these interest free promissory notes as at 30 September 2007 is RR 288,500 thousand (31 December 2006: RR 399,000 thousand). Expected future cash flows were discounted at rates of between 9.6 and 10.6%. These rates were not materially different from current financing rate of the Group.

**Note 15. Provisions for liabilities and charges**

	Provision for holidays	Employee benefits
At 1 January 2007	29,020	1,284,650
Additional provision created	18,223	187,068
Provisions used	(29,020)	(80,593)
<b>At 30 September 2007</b>	<b>18,223</b>	<b>1,391,125</b>

**Employee benefits**

The Group has defined benefit pension and other long-term defined benefit plans that cover most full-time and retired employees. Defined post-employment benefits consist of several unfunded plans providing for lump-sum payments upon retirement, financial support for current pensioners, death benefits, jubilee benefits, old age life pension program. Management has assessed the net present value of these obligations, following the guidelines set out in IAS 19 *Employee Benefits*. Under this method an assessment has been made of an employee's service period with the Group, the expected salary and pension payable having regard to staff turnover statistics,

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**Note 15. Provisions for liabilities and charges (continued)**

**Employee benefits (continued)**

retirement age, and salaries at retirement. The expected liabilities have been discounted to net present value using a rate of 6.75% per year. In view of the relative insignificance of the expense recognized in the consolidated income statement for the year, the additional disclosures required by IAS 19 have not been made.

**Note 16. Accounts payable and accrued charges**

	30 September 2007	31 December 2006
Trade payables	918,198	737,342
Advances received	575,058	411,512
Wages and salary	218,935	300,899
Other payables	116,772	498,329
<b>Total</b>	<b>1,828,963</b>	<b>1,948,082</b>

**Note 17. Other taxes payable**

	30 September 2007	31 December 2006
Deferred VAT	269,122	803,838
Property tax	99,700	112,387
Value added tax	-	94,675
Employee taxes	59,490	92,909
Other taxes	145,810	120,077
<b>Total</b>	<b>574,122</b>	<b>1,223,886</b>

Deferred VAT becomes payable to the tax authorities when the underlying receivable balances are either recovered or written off.

**Note 18. Revenues**

	Nine months ended 30 September 2007	Nine months ended 30 September 2006
Electricity	13,036,277	10,565,760
Heating	11,892,591	10,605,103
Other	2,220,851	2,265,024
<b>Total</b>	<b>27,149,719</b>	<b>23,435,887</b>



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**Note 19. Operating expenses**

	Nine months ended 30 September 2007	Nine months ended 30 September 2006
Fuel	13,495,726	12,632,670
Third party services	2,751,651	2,363,185
Employee benefits	3,776,312	3,207,037
Depreciation	1,938,475	1,777,162
Material expenses	1,433,068	1,170,914
Taxes other than income tax	546,687	591,132
License fee	271,354	236,126
Purchased power	1,070,944	372,775
Provision for impairment of accounts receivable	(52,633)	(106,079)
Insurance	208,793	134,241
Bank services	131,377	109,011
Rental expenses	261,550	150,889
Water usage expenses	736,050	752,350
Amortization of intangible assets	45,942	25,579
Other expenses	144,336	376,282
<b>Total</b>	<b>26,759,632</b>	<b>23,793,274</b>

Employee benefits expenses comprise the following:

	Nine months ended 30 September 2007	Nine months ended 30 September 2006
Salaries and wages, benefits and payroll taxes	3,714,964	3,139,156
Non-governmental pension fund expenses	61,348	67,881
<b>Employee benefits</b>	<b>3,776,312</b>	<b>3,207,037</b>

**Note 20. Net finance expense**

	Nine months ended 30 September 2007	Nine months ended 30 September 2006
Interest income	7,629	10,286
Interest expense	(196,874)	(49,657)
Effect of discounting	4,628	(4,502)
<b>Total</b>	<b>(184,617)</b>	<b>(43,873)</b>

**Note 21. Income tax expense**

	Nine months ended 30 September 2007	Nine months ended 30 September 2006
Current income tax expense	254,547	336,823
Deferred income tax expense (benefit)	46,228	(268,608)
<b>Total income tax expense</b>	<b>300,775</b>	<b>68,215</b>

	Nine months ended 30 September 2007	Nine months ended 30 September 2006
Profit before income tax expense	225,903	(311,195)
Theoretical profit tax charge at an average statutory tax rate of 24%	54,217	(74,687)
Tax effect of items which are not deductible or taxable for taxation purposes	246,558	142,902
<b>Total income tax expense</b>	<b>300,775</b>	<b>68,215</b>

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**Note 21. Income tax expense (continued)**

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 or profit tax purposes. Deferred profit tax assets and liabilities are measured at 24%, the rate expected to be applicable when the assets or liabilities will reverse.

The temporary differences associated with undistributed earnings of subsidiaries amount to RR 23,854 thousand at 30 September 2007 (31 December 2006: RR 38,849 thousand). A deferred tax liability on these temporary differences was not recognized because management controls the timing of the reversal of the temporary differences and they will not reverse in the foreseeable future.

Changes in deferred tax liabilities and assets for the nine months ended 30 September 2006 are presented in the table below:

	1 January 2006	Recognized in profit and loss	30 September 2006
<b>Deferred tax liabilities</b>			
Property, plant and equipment	(5,955,781)	373,901	(5,581,880)
Promissory notes	(20,162)	5,854	(14,308)
<b>Total deferred tax liabilities</b>	<b>(5,975,943)</b>	<b>379,755</b>	<b>(5,596,188)</b>
<b>Deferred tax assets</b>			
Accounts receivable	497,492	(124,344)	373,148
Provisions	28,784	15,156	43,940
Other	4,705	(1,959)	2,746
<b>Total deferred tax assets</b>	<b>530,981</b>	<b>(111,147)</b>	<b>419,834</b>

Changes in deferred tax liabilities and assets for the nine months ended 30 September 2007 are presented in the table below:

	1 January 2007	Recognized in profit and loss	30 September 2007
<b>Deferred tax liabilities</b>			
Property, plant and equipment	(5,371,902)	239,347	(5,132,555)
Promissory notes	(12,335)	4,371	(7,964)
<b>Total deferred tax liabilities</b>	<b>(5,384,237)</b>	<b>243,718</b>	<b>(5,140,519)</b>
<b>Deferred tax assets</b>			
Accounts receivable	418,712	(286,050)	132,662
Provisions	50,301	(2,568)	47,733
Other	4,990	(1,328)	3,662
<b>Total deferred tax assets</b>	<b>474,003</b>	<b>(289,946)</b>	<b>184,057</b>

**Note 22. Earnings per share**

	Nine months ended 30 September 2007	Nine months ended 30 September 2006
Weighted average number of ordinary shares issued (quantity) (See Note 12)	26,116,076,165	26,116,076,165
Net loss for the period	(74,872)	(379,410)
Earnings per ordinary share – basic (in Russian rubles)	(0.003)	(0.015)

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**Note 23. Related parties**

The Group's related parties transactions are disclosed below:

***Parent's subsidiaries***

Transactions with the Parent's subsidiaries were as follows:

	<b>Nine months ended 30 September 2007</b>	<b>Nine months ended 30 September 2006</b>
Purchase of electricity	1,069,933	200,989
License fee	260,725	226,628
	<b>30 September 2007</b>	<b>31 December 2006</b>
Accounts receivable and prepayments	162,565	86,177
Accounts payable and accrued charges	512,069	107,354

***State-controlled entities***

In the normal course of business the Group enters into transactions with other entities under Government control, including Gazprom, Russian railways, and various governmental bodies. Prices for natural gas, electricity and heat are based on tariffs set by FST and RST. Bank loans are provided on the basis of market rates. Taxes are accrued and settled in accordance with Russian tax legislation.

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

	<b>Nine months ended 30 September 2007</b>	<b>Nine months ended 30 September 2006</b>
Electricity and heat sales	16,015,288	14,215,811
Purchase of gas	10,131,422	8,267,386
Rent expense	34,474	2,810
	<b>30 September 2007</b>	<b>31 December 2006</b>
Accounts receivable and prepayments	1,239,190	732,897
Accounts payable and accrued charges	858,049	236,971

Tax balances are disclosed in the balance sheet and Notes 17 and 21. Tax transactions are disclosed in the income statement and Notes 19 and 21.

***Compensations to the Board of Directors and key management***

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

For the reporting period the following compensations were made to the Management Board and Board of Directors:

	<b>Nine months ended 30 September 2007</b>	<b>Nine months ended 30 September 2006</b>
Wages, salaries and bonuses	57,307	19,672
<b>Total</b>	<b>57,307</b>	<b>19,672</b>

**Note 24. Operating leases**

*Operating leases payable*

Operating lease rentals are payable as follows:

	<b>30 September 2007</b>	<b>31 December 2006</b>
Less than one year	10,908	37,058
Between one and five years	24,003	21,419
More than five years	13,270	-
<b>Total</b>	<b>48,181</b>	<b>58,477</b>

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

*Operating leases receivable*

Operating lease rentals are receivable as follows:

	<b>30 September 2007</b>	<b>31 December 2006</b>
Less than one year	37,454	62,815
Between one and five years	77,763	46,179
More than five years	1,450	1,450
<b>Total</b>	<b>116,667</b>	<b>110,444</b>

**Note 25. Commitments**

*Purchase commitments*

The Group has a number of outstanding contracts to purchase natural gas. The quantity of natural gas to be supplied is annually allocated by RAO UES of Russia in coordination with OJSC GAZPROM given the capacity of utilization of alternative fuel and the required fuel reserve fixed by RAO UES of Russia. The purchase price of gas is fixed by the Federal Service of Tariffs. After 30 September 2007 the evaluated volume of supplies under the current contracts will be approximately equal to RR 4,603,415 thousand.

In 2005-2006 long-term gas contracts (until December 2010-2011) were concluded with OJSC Novatek.

*Capital commitments*

In the normal course of business, the Group has outstanding commitments under the contracts for the purchase and construction of property, plant and equipment for RR 1,050,137 thousand.

**Note 26. Contingencies**

*Insurance*

The insurance industry in the Russian Federation is in a developing state. The Group does not have full coverage for its stations, business interruption, or third party liability in respect of property or environmental damage arising from accidents on Group property or relating to Group operations. Until the Group obtains adequate insurance coverage, there is a risk that the loss or destruction of certain assets could have a material adverse effect on the Group's operations and financial position.

*Legal proceedings*

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

**Note 26. Contingencies (continued)**

***Taxation***

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

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

As at 31 December 2006 management believes that its interpretation of the relevant legislation is appropriate and the Group's tax, currency and customs positions will be sustained.

***Environmental matters***

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

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

**Note 27. Financial instruments**

Exposure to credit, interest rate and currency risk arises in the normal course of the Group's business. The Group does not hedge its exposure to such risk.

***Credit risk***

The maximum exposure to credit risk is represented by the carrying amount of each financial asset in the balance sheet.

At the balance sheet date there was a significant concentration of credit risk in respect of trade receivables. The carrying amount of trade receivables, net of the allowance for doubtful debtors, represents the maximum amount exposed to credit risk. The amounts are disclosed in Note 10.

***Foreign exchange risk***

The Group primarily operates on the territory of the Russian Federation. The majority of the Group's purchases are denominated in Russian rubles.

***Interest rate risk***

Changes in interest rates impact primarily loans and borrowings by changing either their fair value (fixed rate debt) or their future cash flows (variable rate debt). Management does not have a formal policy of determining how much of the Group's exposure should be to fixed or variable rates. However, at the time of raising new loans or borrowings management uses its judgment to decide whether it believes that a fixed or variable rate would be more favourable to the Group over the expected period until maturity. Interest rates are disclosed in Note 13.

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**Note 27. Financial instruments (continued)**

*Fair values*

The fair value of available for sale financial assets, restructured trade receivables and promissory notes is discussed in Note 8, Note 10 and Note 14, respectively. Management believes that the fair value of other financial assets and financial liabilities is not significantly different from their carrying amounts.

**Note 28. Events after the balance sheet date**

The Extraordinary General Meeting of Shareholders of OJSC Volga TGC on 14 December 2007 took a decision on an increase in the Company's charter capital through the placement of additional uncertified ordinary shares via open subscription, in the amount of 3,859,000,000, with a nominal value of 1 rouble each. Additional shares of OJSC Volga TGC are issued for cash.