RAO UES
PARENT COMPANY STAND-ALONE IAS FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 1998

PRICEWATERHOUSECOOPERS

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AUDITOR'S REPORT

To the Shareholders and Board of Directors of the Russian Joint Stock Company Unified Energy System of Russia ("RAO UES")

1. We have audited the accompanying balance sheet of RAO UES (that is, RAO UES as a parent company on a stand-alone basis, hereinafter referred to as the "Company") as of 31 December 1998 and the related statements of operations, of cash flows and of changes in shareholders' equity for the year then ended. These financial statements, set out at pages 1 through 25, are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements based on our audit.

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

3. The Company has prepared its financial statements in accordance with International Accounting Standards ("IAS") for the first time in 1998. The accompanying financial statements do not include comparative amounts for the year ended 31 December 1997, as required by IAS.

4. As discussed in Note 7, the Company recorded impairment losses for the year ended 31 December 1998 of RR 66,275 million related to property, plant and equipment. As also indicated in Note 7, it was not possible for management to determine the portion of the impairment loss recorded in 1998 which existed and should have been recorded at 31 December 1997, as required by IAS. Any such portion would reduce the 1998 net loss and correspondingly reduce the 31 December 1997 balance of shareholders' equity.

5. In our opinion, except for the absence of comparative information as described in paragraph 3 and except for the effect on the financial statements of the matter referred to in paragraph 4, the accompanying financial statements present fairly, in all material respects, the financial position of the Company as of 31 December 1998 and the results of its operations and its cash flows for the year then ended, in accordance with IAS.

6. Without further qualifying our opinion, we draw attention to Note 2. The financial statements have been prepared in accordance with accounting policies based on the Company being a going concern. For the year ended 31 December 1998, the Company incurred a net loss of RR 76,489 million. Furthermore, the Company continues to experience significant difficulties settling its tax liabilities, paying creditors and meeting debts as they fall due. These factors in addition to the limitations on tariff increases, poor levels of collection, and the significant economic difficulties in the Russian Federation raise substantial doubt about the ability of the Company to continue as a going concern. The accompanying financial statements do not include any adjustment that might result from the outcome of this uncertainty.

PricewaterhouseCoopers

Moscow, Russian Federation
14 December 1999

RAO UES ("Parent company" stand-alone)
Balance Sheet as at 31 December 1998
(in millions of Russian roubles expressed in terms of the purchasing power of the Russian rouble as at 31 December 1998)
(comparative information for 1997 not presented, as 1998 represents first year full financial statements prepared)

	Notes	31 December 1998
Assets		
Non-current assets		
Property, plant and equipment (net of impairment loss of RR 66,275 million in 1998; zero in 1997)	7	79,861
Investments	8	15,911
Other non-current assets	9	2,304
Total non-current assets		98,076
Current assets		
Cash and cash equivalents	10	158
Accounts receivable and prepayments	11	12,323
Inventories		276
Other current assets		216
Total current assets		12,973
Total assets		111,049
Shareholders' equity and liabilities		
Shareholders' equity		
Share capital	12	
Ordinary shares (nominal value RR 20,521 million)		65,690
Preference shares (nominal value RR 1,038 million)		3,416
Treasury shares	12	(250)
		68,856
Retained earnings and other reserves		19,058
Total shareholders' equity		87,914
Non-current liabilities		
Deferred profits tax liabilities	13	9,627
Non-current debt	14	893
Total non-current liabilities		10,520
Current liabilities		
Current debt and current portion of non-current debt	15	1,504
Accounts payable and accrued charges	16	5,713
Taxes payable	17	5,398
Total current liabilities		12,615
Total shareholders' equity and liabilities		111,049

Chairman of the Management Board — Chubais A. B.

First Deputy Chairman of the Management Board — Zelinsky A.M.

RAO UES ("Parent company" stand-alone)

Statement of Operations for the year ended 31 December 1998

(in millions of Russian roubles expressed in terms of the purchasing power of the Russian rouble as at 31 December 1998)
(comparative information for 1997 not presented, as 1998 represents first year full financial statements prepared)

	Notes	Year ended 31 December 1998
Revenues		
Transmission fees	4	14,031
Imputed interest income	4	1,440
Heat and electricity		839
Rental income		424
Investment income		363
Other income		969
Total revenues		18,066
Operating Costs	18	
High voltage network operating costs		7,033
Rental costs		2,532
Repairs and maintenance		1,945
Administrative and general		1,351
Heat and electricity generation costs		1,124
Taxes other than on income		1,140
Doubtful debtors expense		253
Tax interest, fines and penalties		185
Other expenses		1,019
		16,582
Diminution in carrying value of investments	8	18,418
Impairment loss	7	66,275*
Total costs and other deductions		**101,275**
Loss for operations		**(83,209)**
Monetary loss		(1,720)
Foreign exchange loss		(1,583)
Interest expense		(549)
Total monetary effects		(3,852)
Loss before taxation		(87,061)
Profits tax charge		(1,224)
Deferred profits tax benefit		11,796
Total tax benefit	13	**10,572**
Net loss		**(76,489)**
Loss per share (in Russian roubles)	4, 19	(1.881)

* – not possible to determine amount of loss which applies to years prior to 1998

Chairman of the Management Board — Chubais A.B.

First Deputy Chairman of the Management Board — Zelinsky A.M.

RAO UES (“Parent company” stand-alone)
Statement of Cash Flows for the year ended 31 December 1998

(in millions of Russian roubles expressed in terms of the purchasing power of the Russian rouble as at 31 December 1998)
(comparative information for 1997 not presented, as 1998 represents first year full financial statements prepared)

	Notes	Year ended 31 December 1998
CASH FLOWS FROM OPERATING ACTIVITIES:	4	
Net loss before taxation		**(87,061)**
Adjustments to reconcile net loss before taxation to net cash provided by operations:		
Depreciation and amortisation		9,553
Impairment loss		66,275
Foreign exchange loss		1,649
Imputed interest income on receivables		(1,440)
Diminution in carrying value of investments		18,418
Doubtful debtors expense		253
Dividends receivable and received in kind		(363)
Monetary effects on non-operating balances		(2,330)
Adjustment for non-cash investing activities		(5,824)
Adjustment for non-cash financing activities		250
Other		584
Cash used in operating activities before working capital changes		**(36)**
Decrease in accounts receivables and prepayments		2,721
Decrease in other current assets		67
Decrease in inventories		307
Increase in accounts payable and accrued charges		1,934
Decrease in taxes payable other than profits tax		(3,403)
Profits tax paid/non-cash		(684)
Profits tax paid/cash		(563)
Net cash provided by operating activities		**343**
CASH FLOWS FROM INVESTING ACTIVITIES:		
Additions to property, plant and equipment		(78)
Dividends received		27
Net cash used in investing activities		**(51)**
CASH FLOWS FROM FINANCING ACTIVITIES		
Effect of inflation on financing activities		722
Proceeds from issuance of current debt		2,078
Reductions of loan		(3,433)
Proceeds from issuance of non-current debt		880
Interest paid		(366)
Dividends paid		(81)
Net cash used in financing activities		**(200)**
Effect of inflation on cash and cash equivalents		**(62)**
Increase in cash and cash equivalents		**30**
Cash and cash equivalents as at 31 December 1997		**128**
Cash and cash equivalents as at 31 December 1998	10	**158**

Chairman of the Management Board — Chubias A. B.

First Deputy Chairman of the Management Board — Zelinsky A.M.

RAO UES ("Parent company" stand-alone)
Statement of Changes in Shareholders' Equity for the year ended 31 December 1998
(in millions of Russian roubles expressed in terms of the purchasing power of the Russian rouble as at 31 December 1998)
(comparative information for 1997 not presented, as 1998 represents first year full financial statements prepared)

	Ordinary share capital	Preference share capital	Treasury shares	Retained earnings and other reserves	Total shareholders' equity
At 31 December 1997	65,690	3,416	(250)	95,942	164,798
Net loss	-		-	(76,489)	(76,489)
Dividends	-		-	(395)	(395)
At 31 December 1998	65,690	3,416	(250)	19,058	87,914

Chairman of the Management Board — Chubais A.B.

First Deputy Chairman of the Management Board — Zelinsky A.M.

Note 1: The Company and its operations

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

Specifically, the following assets which remain in service as of the balance sheet date represent assets transferred to RAO UES upon privatisation:

> ***High voltage network:*** The high voltage network connects all but two regions of the Russian Federation. The Company maintains this network and charges a transmission fee to users of the network;
>
> ***Generating stations:*** Thirteen generating stations were transferred to the Company, of these ten stations are leased to its investees. The remaining stations operate as electricity producers and sell electricity direct to the wholesale electricity market;
>
> ***Regional generation and distribution companies:*** The Company received ownership interest in 70 regional generation and distribution companies ("Energos"). These ownership interests range from 14.2% to 100%; and
>
> ***Other:*** In addition, a number of other utility-related enterprises and construction companies were transferred to RAO UES.

The Company is required to provide access to the high voltage network, maintain it and develop the unified electricity system of the Russian Federation. The Central Dispatch Centre ("CDC"), a 100% owned subsidiary of the Company, is sub-contracted by the Company to undertake the technical management and balancing of the high voltage network as well as operate the wholesale electricity market. The Company develops, maintains and replaces the high voltage network as needed and as resources are available. The construction of generation and distribution assets is undertaken primarily through joint construction projects between the Company and the Energos. In 1998 the Company established itself as the export agent for entities selling electricity through the wholesale electricity market. The Company receives a commission for these services.

At 31 December 1998, the number of employees of the Company was approximately 16,000.

The Company's registered office is located at 7, Kitaigorodsky Proezd, 103074, Moscow, Russia.

Relations with the State. At 31 December 1998, the Russian Federation owned 52.7% of RAO UES, which represents 54.9% of the ordinary shares issued. As discussed in Note 12, only ordinary shares have voting rights. The Government of the Russian Federation directly affects the Company's operations through regulation by the Federal Energy Commission ("FEC") in respect of the transmission fee it may charge. Historically, the fee has been based on a "cost-plus" system, meaning the 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 the IAS basis of accounting. In practice, decisions relating to the transmission fee are impacted significantly by social and political considerations, causing significant delays in tariff decisions being received and tariff increases which are less than required.

As a condition to privatisation in 1992, the government of the Russian Federation imposed an obligation on the Energos (UES Group entities) to provide connection in respect to the supply of electricity and the supply of heating to customers in the Russian Federation. Governmental Resolution Number 1 was issued on 5 January 1998 and amended on 17 July 1998. Except for certain governmental and other entities, this resolution allows electric power suppliers, including the Company's investees, to discontinue the supply of electricity and heat to delinquent customers.

As described in Note 21, the government's economic, social and other policies affect the Company's financial position.

Note 2: Going concern

For the year ended 31 December 1998, the Company incurred a net loss of RR 76,489 million. The Company continues to experience significant difficulties settling its tax liabilities, paying trade creditors, and meeting debts as they fall due. In addition, three of the Company's investees are currently in receivership. Certain other investees are also currently defending claims made against them in Arbitration Courts.

The Company is affected by government policy through control of tariffs and other factors that directly impact its own operations and those of its principal investees, the Energos. In recent years the Regional Energy Commissions, that control the tariffs of the Energos, have not always permitted tariff increases in line with inflation and thus some tariffs are insufficient to cover all the costs of generation and distribution. Moreover, these tariffs consider costs only on a Russian statutory basis and, accordingly, exclude significant additional costs under the IAS basis of accounting.

In common with many Russian companies, the Company and its Energo investees have experienced a significant increase in the non-payment or slow payment for services, which has had an adverse impact on cash flow. Due to widespread non-payment by end consumers, the ability of the Company's investees (the Energos) to pay their transmission fees has suffered which, in turn, has impacted the Company's ability to meet its obligations.

In addition, during 1998, the economy of the Russian Federation entered a period of financial instability. The impact includes, but is not limited to: a steep decline in prices of domestic debt and equity securities, a severe devaluation of the currency, a moratorium on foreign debt repayments, an increasing rate of inflation and increasing rates of interest on government and corporate borrowings. A return to economic stability is dependent to a large extent on the effectiveness of the fiscal measures taken by the government and other actions beyond the Company's control. The operations of the Company, and those of similar companies in the Russian Federation, have been significantly affected by these developments and by the country's unstable economy caused in part by the currency volatility in the Russian Federation. Due to the inherent uncertainty, it is not possible to predict the extent, severity or duration of the current economic difficulties nor quantify what impact they may have on the current financial position or future operations of the Company.

Management believes that the factors noted above will, among other effects, continue to affect the Company's earnings and its ability to recover its investments in property, plant and equipment and accounts receivable. Despite the economic conditions described above, management believes that the Company will be able to continue as a going concern for the foreseeable future. The Company's operations and those of its Energo investees are of strategic importance to the Russian economy. Management is taking steps to improve cash collections, as are its Energo investees. Improvements in tariff rates are being negotiated by both the Company and its Energo investees. Management is also discussing potential new sources of finance. The eventual outcome of these measures is uncertain.

The Company's financial statements have been presented in accordance with accounting policies based on the Company being a going concern. The going concern basis contemplates the realisation of assets and the satisfaction of liabilities in the normal course of business. Accordingly, the financial statements do not include any adjustments that might result should the Company be unable to continue as a going concern.

Note 3: Basis of presentation

Effective 1 January 1998, the Russian Government re-denominated the Russian rouble downward on a one thousand-to-one basis. These financial statements are expressed in terms of the purchasing power of the redenominated Russian rouble (RR) at 31 December for all years presented.

(in millions of Russian roubles expressed in terms of the purchasing power of the Russian rouble as at 31 December 1998)

Note 3: Basis of presentation (continued)

Except as indicated below and in Note 8, the financial statements of the Company have been prepared in accordance with International Accounting Standards ("IAS"). That is, the financial statements are those of RAO UES as a "parent company" on a stand-alone basis and, as such, subsidiaries and associates are presented as investments in the financial statements. Consolidated financial statements for the RAO UES Group are produced separately for the year ended 31 December 1998 and include the relevant financial information regarding RAO UES and its subsidiaries and associates.

The Company maintains its own books of accounts and prepares its statutory financial statements in accordance with RAR. The accompanying financial statements are based on the statutory records, which are maintained under the historical cost convention except for revaluations of property, plant and equipment (see Note 7), with adjustments and reclassifications for the purpose of fair presentation in accordance with IAS as issued by the International Accounting Standards Committee.

These financial statements do not comply with IAS 1 (revised 1997), "Presentation of Financial Statements" because comparative amounts in respect of all statements are not presented for the year ended 31 December 1997. The financial statements of the Company were prepared for the first time for the year ended 31 December 1998. It is not practical to prepare comparatives and their related disclosures.

The preparation of financial statements in conformity with IAS requires management to make prudent estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates have principally been made in respect to the impairment provisions, the denominations in carrying value of investments, and the discounting to fair value of trade receivables. Actual results could differ from these estimates.

Inflation accounting. The adjustments and reclassifications made to the statutory records for purposes of IAS presentation include the restatement for changes in the general purchasing power of the Russian Rouble in accordance with IAS 29, "Financial Reporting in Hyperinflationary Economies." IAS 29 requires that the financial statements prepared in the currency of a hyperinflationary economy be stated in terms of the measuring unit current at the balance sheet date.

The conversion factors are derived from the Russian Federation Consumer Price Index ("CPI") published by the Russian State Committee on Statistics (Goscomstat), and from indices obtained from other published sources for years prior to 1992. The index used to restate the balance sheet, based on 1988 prices, (1988 = 100) as at 31 December 1998 under respective conversion factors are:

Year	Indices	Conversion Factor
1994	211,612	5.8
1995	487,575	2.5
1996	594,110	2.1
1997	659,403	1.8
1998	1,216,401	1.0

Note 3: Basis of presentation (continued)

The significant guidelines followed in restating these financial statements are:

- all amounts are stated in terms of the measuring unit current at 31 December 1998;
- monetary assets and liabilities are not restated because they are already expressed in terms of the monetary unit current at 31 December 1998;
- as described in Note 7, tangible fixed assets are stated at amounts based upon an independent appraisal performed as at 31 December 1997. The appraisal values have been restated by applying relevant conversion factors together with adjustments for additions, disposals and depreciation, all restated by applying the relevant conversion factors;
- other non-monetary assets and liabilities (items which are not expressed in terms of the monetary unit current at 31 December 1998) and shareholders' equity, including the share capital, are restated by applying the relevant conversion factors;
- all items in the statements of operations and of cash flows are restated by applying appropriate conversion factors to restate the amounts in terms of the measuring unit current at 31 December 1998 with the exception of depreciation and amortisation, diminution in carrying value of investments and the provision for doubtful accounts; and
- the effect of inflation on the Company's net monetary position is included in the statement of operations as a net monetary loss.

The statement of operations includes a net monetary loss of RR 1,720 million for the year ended 31 December 1998 because, on average the Company had net monetary assets during the year. Since 31 December 1998, inflation has continued. As of 31 October 1999 the CPI was 1,621,463 (1988=100), representing inflation of 33.3 percent since 31 December 1998.

Note 4: Summary of significant accounting policies

Early adoption of standards. International Accounting Standards issued as of 31 December 1998, with the exception of IAS 39 "Financial Instruments: Recognition and Measurement", have been reflected in the financial statements, as applicable to the Company.

Investments. Investments in subsidiaries, associates and other long-term investments are carried at historical cost restated to the equivalent purchasing power of the Russian rouble at 31 December 1998. Provision is made where, in the opinion of management, there is a permanent diminution in value below the carrying amount.

Property, plant and equipment. Property, plant and equipment as at 31 December 1998 is stated at depreciated replacement cost, based upon values determined by professional valuation at 31 December 1997, and adjusted for 1998 additions, disposals, depreciation and restated for the impact of inflation by applying relevant conversion factors from the appropriate date.

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

Under Russian law, the land on which the Company carries out its activities is the property of the state and, therefore, is not included in the balance sheet.

Fixed assets are depreciated on a straight-line basis over their remaining useful life. The average remaining useful life as at 31 December 1998, weighted by the closing net book value of these assets, is shown in the table below.

(in millions of Russian roubles expressed in terms of the purchasing power of the Russian rouble as at 31 December 1998)

Note 4: Summary of significant accounting policies (continued)

Type of facility	Years
Electricity transmission	17
Electricity generation	16
Other	10

Depreciation on additions in the year is calculated on a straight-line basis over the estimated useful life of the asset. The average useful lives of assets by type of facility are as follows:

Type of facility	Years
Electricity transmission	40
Electricity generation	50
Other	15

Social assets are excluded from the financial statements as they are not expected to result in future economic benefits to the Company. However, liabilities for social expenditures are accrued.

Foreign currency. Monetary assets and liabilities which are held by the Company and denominated in foreign currencies at 31 December 1998 are translated into Russian roubles at the exchange rates prevailing at that date. Foreign currency transactions are accounted for at the exchange rates prevailing at the date of the transactions. Gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in the statement of operations.

Cash and cash equivalents. Cash comprises cash in hand and cash deposited in banks. Cash equivalents comprise short-term investments that may be readily converted into cash, are not subject to the risk of significant changes in value and have an original maturity of three months or less.

The statement of cash flows has been prepared in accordance with IAS 7 "Cash Flow Statements" and has been restated for the effects of inflation, in accordance with IAS 29 "Financial Reporting in Hyperinflationary Economies". The Company relies to a significant extent on non-cash transactions. Investing activities and financing activities, as disclosed in the statement of cash flows, represent actual cash transactions. The total of operating activities also represents actual cash flow transactions from operations. However, individual items within this part of the cash flow statement are stated inclusive of both cash and non-cash transactions. Management believes that the benefits of such information is outweighed by the cost of preparation.

Accounts receivable and prepayments. Accounts receivable from entities that the Company controls or has significant influence over, are considered by management to be fully recoverable. However, to reflect the timing of future settlements the balances have been discounted to their fair value using an imputed rate of interest determined by management. Accounts receivable with other entities are not discounted. The impact of the timing of future settlements is not considered material. An allowance for doubtful debtors, as determined by management, is recorded to reduce the carrying value of these accounts receivable to their estimated net realisable value. All accounts receivable include value added taxes which are payable to tax authorities upon collection of such receivables.

Value added tax on purchases and sales. Value added tax at 20 percent is applied to the majority of purchases and sales. Value added tax is reclaimable against current value added tax obligations upon payment and receipt of goods or services rendered. These obligations are recorded net of the reclaimed value added tax on purchases. Value added tax on purchases for which either payment has not been made or goods have not been received is recorded as an asset in the balance sheet.

Note 4: Summary of significant accounting policies (continued)

Inventories. Inventories are valued at the lower of net realisable value or weighted average cost, restated to the equivalent purchasing power of the Russian rouble at 31 December 1998. Provision is made for potential losses on obsolete or slow-moving inventories, taking into account their expected use and future realisable value.

Deferred profits taxes. Deferred tax assets and liabilities are calculated in respect of temporary differences in accordance with IAS 12 "Income Taxes", revised 1996 ("IAS 12"). IAS 12 requires the use of a balance sheet liability method for financial reporting and accounting for deferred income taxes. Deferred income taxes are provided for all temporary differences arising between the tax basis of assets and liabilities and their carrying values for financial reporting purposes. A deferred profits tax asset is recorded only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised. Deferred profits tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates that have been enacted or substantively enacted at the balance sheet date. These rates for the Group approximate to 35 percent.

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

Pension and post-employment benefits. The Company's mandatory contributions to the governmental pension scheme are expensed when incurred. Discretionary pension and other post-employment benefits are not material.

Environmental liabilities. Liabilities for environmental remediation are recorded when it is probable that an obligation exists and the amounts can be reasonably estimated.

Revenue Recognition. Revenue is recognised for IAS financial statement purposes on the accrual basis. Transmission fee revenue is based upon management's estimate of the fair value of such revenue, given the expected timing of future receipt of payments. The difference between the nominal amount and the fair value is recognised as imputed interest income on a time proportion basis up to the date of settlement. Billings for transmission fees are based upon tariffs authorised and approved by the Federal Energy Commission on an annual basis. Revenue figures are presented exclusive of value added taxes.

Loss per share Loss per share is determined by dividing the net loss, as adjusted for the declared dividend for preferred shareholders declared in 1999, by the weighted average number of ordinary shares outstanding during the reporting year. There is no potential dilution for the ordinary shareholders.

Treasury shares. Treasury shares are stated at weighted average cost, restated to the equivalent purchasing power of the Russian rouble at 31 December 1998. Any gains or losses arising on the disposal of treasury shares are recorded direct to the statement of changes in shareholders' equity.

(in millions of Russian roubles expressed in terms of the purchasing power of the Russian rouble as at 31 December 1998)

Note 5: Segmental information

Primary reporting segments – business segments The Company is organised into three main business segments:

- ***"Transmission"*** - this segment owns, constructs, maintains and operates the high voltage electricity transmission network.
- ***"Long-term investments"*** – this segment comprises the Company's long-term investments including its investment in the generation and distribution companies that comprise the RAO UES Group. These subsidiary and associated investees are described in Note 6.
- ***"Generation, leasing and other"*** – the Company owns thirteen power stations. Ten of these power stations are leased under operating leases to investees and the remaining three power stations are operated as electricity producers and sell directly to the wholesale electricity market. The Company also participates in joint ventures with Energos and other entities to construct new power stations. Other operations include treasury and corporate activities of the Company.

Year ended 31 December 1998	**Transmission**	**Long term investments**	**Generation, leasing and other**	**Total**
Revenues	15,389	363	2,314	18,066
Segment result	(34,631)	(18,116)	(29,111)	(81,858)
Administrative and general costs				(1,351)
Monetary effects				(3,852)
Loss before taxation				(87,061)
Profits tax benefit				10,572
Net loss				(76,489)
Capital expenditure	1,439	-	615	2,054
Depreciation and amortisation	6,561	-	2,992	9,553
Impairment loss	39,552	-	26,723	66,275
Doubtful debtors expense	253	-	-	253
Other non-cash expenses	383	18,418	169	18,970
As at 31 December 1998				
Segment total assets	78,391	18,331	14,327	111,049
Segment liabilities	5,601	1,350	1,796	8,747
Unallocated liabilities				14,388
Total liabilities				23,135

(in millions of Russian roubles expressed in terms of the purchasing power of the Russian rouble as at 31 December 1998)

Note 5: Segmental reporting (continued)

Secondary reporting segments - geographical segments The Company operates in seven geographical areas within the Russian Federation. These geographical areas correspond to the regions established for system operation. As noted above, the Company owns, operates and maintains the high voltage transmission network. The transmission network is located throughout the territory of the Russian Federation but is recorded in the books of the Company without regard to geographic location. As a consequence it is not practicable to split the transmission network assets of RAO UES on a geographical basis. The transmission network assets have, therefore, been included as part of the RAO UES geographical segment.

In each of the seven regions RAO UES has representation offices that co-ordinate activities on behalf of the Company.

	Revenues 1998	Total assets 1998	Capital expenditure 1998
RAO UES	896	88,185	388
Siberia	3,656	7,926	647
Urals	4,262	7,098	243
Centre	4,831	4,665	149
North-West	1,699	1,887	300
East	485	449	70
Mid-Volga	1,268	436	28
South	969	403	229
Total	18,066	111,049	2,054

Note 6: Related Parties

The Company controls or has significant influence over the Energos and stand-alone power stations throughout the Russian Federation. These subsidiary and associated investees of the Company are its principal related parties and are listed in the tables below.

PRINCIPAL SUBSIDIARY INVESTEES

Regional generation and distribution companies

Centre

Astrakhanenergo
Belgorodenergo
Ivenergo
Kalugaenergo
Kostromaenergo
Kurskenergo
Lipetskenergo
Mosenergo
Nizhnovenergo
Orelenergo
Ryazanenergo
Tambovenergo
Tulaenergo
Tverenergo
Vladimirenergo
Volgogradenergo
Vologdaenergo
Voronezhenergo
Yarenergo

North-West

Arkhenergo
Bryanskenergo
Karelenergo
Kolenergo
Komienergo
Lenenergo
Novgorodenergo
Pskovenergo
Smolenskenergo
Yantarenergo

South

Dagenergo
Ingushenergo
Kabbalkenergo
Kalmenergo
Karachaevo-Cherkesskenergo
Kubanenergo
Rostovenergo
Sevkavkazenergo
Stavropolenergo

Ural

Chelyabenergo
Kirovenergo
Kurganenergo
Orenburgenergo
Permenergo
Sverdlovenergo
Tumenenergo
Udmurtenergo

Siberia

Altaienergo
Buryatenergo
Chitaenergo
Khakasenergo
Omskenergo
Tomskenergo

Middle Volga

Chuvashenergo
Marienergo
Mordovenergo
Penzaenergo
Samaraenergo
Saratovenergo
Ulyanovskenergo

East

Amurenergo
Dalenergo
Khabarovskenergo
Kolymaenergo
Kamchatskenergo
Magadanenergo
Sakhalinenergo

Note 6: Related Parties (continued)

SUBSIDIARY INVESTEES (continued)

Hydrogenerating companies

Bureyskaya GES
Kabbalk GES
Kamskaya GES
Taimyrenergo
Kaskad Verhnevolzhskih GES
Sayano-Shushenskaya GES
Sulakenergo
Volzhskaya GES (Volzhsk)
Volzhskaya GES (Zhigulevsk)
Votkinskaya GES
Zeiskaya GES
Zelenchugskie GES

Thermal generating companies

Berezovskaya GRES –1
Cherepetskaya GRES
Gusinoozerskaya GRES
Konakovskaya GRES
Kostromskaya GRES
Krasnoyarskaya GRES –2
Kuban GRES
Nevinomysskaya GRES
Novocherkasskaya GRES
Pechorskaya GRES
Permskaya GRES
Pskovskaya GRES
Ryazanskaya GRES
Stavropolskaya GRES
Troitskaya GRES
North-West Station
ZAO Lutek

Construction companies

Cherkeigesstroi
Sevkavgidroenergostroi
Zeyagesstroi

Other

Central Dispatch Centre

ASSOCIATE INVESTEES

Bashkirenergo
Krasnayarskenergo
Yakutskenergo
Novosibirskenergo

Significant balances with subsidiary and associated related parties
Subsidiaries and associates, as listed above, are carried as long-term investments at cost as disclosed in Note 8. Amounts due from these related parties are disclosed as trade receivables in Note 11. These related parties provided construction services to the Company during the year amounting to RR 893 million. As at 31 December 1998 outstanding construction liabilities with these related parties amounted to RR 725 million.

Significant transactions with subsidiary and associated related parties
As shown in the Statement of Operations from year ended 31 December 1998, substantially all revenue is received from the above subsidiary and associate related parties, as they are the main customer in respect to transmission fees. In addition, RR 261million and RR 433 million included within high voltage network operating costs and repairs and maintenance, respectively, arise with these related parties.

Shares of RAO UES held by subsidiaries and associates
As at 31 December 1998 43,746,473 ordinary and 11,878,882 preference shares of the Company are held by subsidiaries and associates.

(in millions of Russian roubles expressed in terms of the purchasing power of the Russian rouble as at 31 December 1998)

Note 6: Related Parties (continued)

Other related parties

The Association of Electric Power Engineers – Integral Electric Power Complex (known as Corporation "EEK" – hereinafter referred to as EEK) is a non-profit organisation, made up of members, who are almost exclusively entities operating in the Russian power sector. RAO UES and its subsidiaries hold a majority of the voting power in EEK. In addition, a former Chairman of the Board of Directors of RAO UES is the President of EEK and is authorised to direct its activities. RAO UES' holding in EEK is included in 'Other Investments' and is not material. The primary service provided by EEK to the Company is the use of its promissory notes to facilitate the mutual settlement of the Company's outstanding debtors with third parties as described in Note 4. At the year end the Company held promissory notes of EEK of RR 300 million included in other receivables and had outstanding liabilities to EEK of RR 528 million included in other creditors. Certain current and former members of the RAO UES management also hold management positions in the EEK Group.

Note 7: Property, plant and equipment

	Electricity Generation	Electricity Transmission	Construction in Progress	Other	Total
Appraised value / Cost					
Opening depreciated replacement cost as at 31 December 1997	26,746	84,987	57,849	3,055	172,637
Additions	1	2	2,195	174	2,372
Transfers	1,173	6,649	(9,001)	1,179	-
Disposals	-	(149)	(573)	(65)	(787)
Transfers to investments	(3,473)	-	(15,060)	-	(18,533)
Closing balance as at 31 December 1998	24,447	91,489	35,410	4,343	155,689
Depreciation					
Charge for the year	(2,633)	(6,528)	-	(392)	(9,553)
Impairment loss	(19,197)	(31,496)	(15,582)	-	(66,275)
			-		
Closing balance as at 31 December 1998	(21,830)	(38,024)	(15,582)	(392)	(75,828)
Net book value as at 31 December 1998	2,617	53,465	19,828	3,951	79,861
Net book value as at 31 December 1997	26,746	84,987	57,849	3,055	172,637

(in millions of Russian roubles expressed in terms of the purchasing power of the Russian rouble as at 31 December 1998)

Note 7: Property, plant and equipment (continued)

The Company leases ten power stations to its Energo investees under operating leases. The carrying value of leased assets included in the above table is shown below.

Appraised value / Cost	22,909
Accumulated depreciation	(2,523)
Impairment change	(17,416)
Net book value	2,970

Future rental income due under the non-cancellable operating leases shown in the table below is based on the 1999 rental income which has not been adjusted for the effects of inflation.

Rental income due:	
Less than 1 year	661
Two to five years	1,385
Total	2,046

Management commissioned an independent third party appraiser, the RAO UES Valuation Consortium led by Ernst & Young (CIS) Limited, to perform a valuation of the Company's property, plant and equipment as at 31 December 1997. The basis of the valuation was depreciated replacement cost. The appraisal values have been restated for the impact of inflation and the 31 December 1998 amounts have been determined based on adjustments for additions, disposals and depreciation during the year ended 31 December 1998.

The year ended 31 December 1998 was the first year that the Company prepared financial statements under IAS. In the absence of IAS cost figures, it was not possible to calculate whether any revaluation surplus arose on an IAS basis as a consequence of the appraisal performed as at 31 December 1997. The net revaluation adjustment from the RAR carrying value of the property, plant and equipment was recorded within retained earnings and other reserves as at 31 December 1997.

Construction in progress represents the carrying value of property, plant and equipment that has not yet been put into production, primarily representing generating stations and high voltage network under construction. Many of these construction projects are joint ventures between the Company and Energos or other third parties, each party contributing cash and assets to the venture. The Company has included its share of the full carrying value of each project in construction in progress. Upon completion of these projects a legal entity is normally formed with ownership generally being in proportion to amounts contributed to the venture. During 1998 RR 18,533 million was transferred to investments following the completion and incorporation of certain construction projects.

Depreciation is recorded beginning when an asset is available for service.

Other assets include motor vehicles, computer equipment, office fixtures and other equipment.

Additions to operational fixed assets principally comprise the transfer of completed projects from construction in progress. Additions to property, plant and equipment principally comprise work completed on construction in progress. Approximately 87% of the additions to construction in progress have been settled through mutual settlement, barter and other non-cash means, 3% settled through cash means and the remaining 10% represents an increase in liabilities to constructors.

(in millions of Russian roubles expressed in terms of the purchasing power of the Russian rouble as at 31 December 1998)

Note 7: Property, plant and equipment (continued)

Impairment. As more fully described at Note 2, the continuing economic crisis in the Russian Federation has had a significant negative impact on the Company. Those effects include but are not limited to substantial reduction in the settlement of the Company's receivables. In addition, these effects are exacerbated by the tariff-setting practices that impact investees (the Company's customers) and those that directly impact the Company. Tariff setters consider only costs determined on a Russian statutory accounting basis. As a result of these practices, the tariffs do not consider the significantly higher costs under IAS resulting from depreciation expense, doubtful debtors expense and the financing of uncollected receivables.

As a result of the above, management has reassessed the recoverability of property, plant and equipment as at 31 December 1998. Value in use of cash generating units have been estimated through a review of estimated future discounted cash flows. Management consider that the high voltage network, three generating stations, ten leased stations represent cash generating units. Discount rates approximating to 27 percent reducing over time to 9 percent have been used to discount these future cash flows. Based upon this reassessment, management recorded an impairment loss of RR 66,275 million as at 31 December 1998 related to the IAS carrying value of the Company property, plant and equipment. It was not possible to determine the portion of the 1998 impairment loss, which existed and should have been recorded at 31 December 1997, as required by IAS.

Management cannot predict with certainty the length or impact of the current economic crisis, nor the impact of future changes in fiscal, political and tariff setting policies. Management has used various assumptions in the calculation of the recoverable value of property, plant and equipment. Variations in these assumptions may give rise to a significantly different amount for the impairment loss. In management's opinion, this loss represents the best estimate of the impact of impairment as a result of the current economic conditions in Russia.

Note 8: Investments

	Subsidiaries and associates	Other investments	Total
Carrying value as at 31 December 1997	12,549	2,534	15,083
Additions	177	-	177
Transfer of fixed assets	18,533	-	18,533
Transfers from other long term assets	536	-	536
Permanent diminution in carrying value	(17,295)	(1,123)	(18,418)
Carrying value as at 31 December 1998	14,500	1,411	15,911

Investments in subsidiaries and associates

The subsidiary and associate investments were transferred to the Company by the Russian Federation on and after its incorporation into a joint stock company. The Company is restricted, by law, in its ability to sell its subsidiary and associated investees and requires the approval of the Government of the Russian Federation for any disposal.

In 1998 the Company created several new generation entities through the incorporation of some of its fixed assets and assets under construction. The carrying value of these assets transferred in return for equity is included as the cost of the investment in these entities as at 31 December 1998.

The carrying value of these investments have been adjusted for the impairment determined by management as at 31 December 1998. In determining the impairment, indicators of the value of investments have been obtained by reference to the investee's net assets. The resulting permanent diminution of RR 18,418 million has been charged to the statement of operations.

(in millions of Russian roubles expressed in terms of the purchasing power of the Russian rouble as at 31 December 1998)

Note 8: Investments (continued)

Additions to subsidiary and associated investments of RR 177 million were financed through non-cash transactions. The transfer from other long-term investments of RR 536 million is from equity prepayments as described in Note 9.

Other investments
Other investments primarily comprise investments in entities that are in receivership or are located in the CIS (Confederation of Independent States). The investments are presented net of management's estimate of a permanent diminution in value.

Note 9: Other non-current assets

	31 December 1998
Prepayments for equity in subsidiaries and associates	1,880
Other	424
	2,304

Prepayments for equity in subsidiaries and associates
The Company has agreements in place with some of the Energos under which the Company prepays for future issues of equity in the Energo. The number of shares to be issued will be determined at a future point in time. The equity prepayments are utilised by the Energos to fund the construction of generation and distribution fixed assets. The prepayments are accounted for as monetary items until equity in the underlying Energo is issued. In 1998 the Company received prepaid equity of RR 536 million in terms equivalent to the purchasing power of the Russian rouble at 31 December 1998. Additions to prepayments for equity amounted to RR 1,147 million which were financed through non-cash transactions.

Note 10: Cash and cash equivalents

	31 December 1998
Cash at bank and in hand	77
Cash equivalents	81
	158

Note 11: Accounts receivable and prepayments

	31 December 1998
Trade receivables	10,054
Other receivables	1,474
(Net of allowance for doubtful accounts of RR 2,406 m for 1998)	
Advances to suppliers	602
Prepayments and accrued income	100
Value added tax recoverable	93
	12,323

(in millions of Russian roubles expressed in terms of the purchasing power of the Russian rouble as at 31 December 1998)

Note 11: Accounts receivable and prepayments (continued)

Trade receivables are due from entities that the Company controls or has significant influence with and include amounts due for transmission fees and leasing of power stations. These receivables have been discounted to their fair value, at the balance sheet date, to reflect the estimated future timing of settlements and are shown net of unearned imputed interest of RR 2,884 million. Management considers the trade receivables as fully recoverable balances. Trade receivables are contractually receivable as at the year end but due to the estimated future timing of settlements RR 2,292 million is expected to be recovered within one to two years and RR 251 million within two to five years.

Other receivable and prepayment balances are based on the estimated net realisable amount, hence the outstanding receivables are shown net of provisions. Management believes that the Company will be able to realise the net other receivable amount through direct collections and other non-cash settlements (in 1998, approximately 70% of the settlements of the Company's accounts receivable and prepayments were made via non-cash settlements).

Note 12: Shareholders' equity

Share Capital	Number of shares issued	31 December 1998
Ordinary shares	41,041,753,984	65,690
Preference shares	2,075,149,384	3,415
		69,105

The authorised number of ordinary shares is 47,509,289,488, with a nominal value per share of 0.5 Russian roubles. All authorised preference shares have been issued. The value of the share capital is stated in terms of the purchasing power of the Russian rouble at the balance sheet date.

Ordinary shares and preference shares. Dividends are declared independently for ordinary and preference shares. Preference shares carry no voting rights except when dividends on preference shares have not been paid. Preference shares are not convertible into ordinary shares and are entitled to a minimum annual dividend of 10 percent of net adjusted statutory profit. In liquidation, preference shares are first paid liquidation value and any unpaid dividends and then participate equally in the distribution of remaining assets with ordinary shares.

The statutory accounts of the Company are the basis for the annual profit distribution and other appropriations. The specific Russian legislation referring to the funds available for distribution identifies the basis as the current year net profit. In 1998 the profit for distribution for the Company, RAO UES, as disclosed in its statutory accounts, was RR 3,017 million. However this legislation as well as other statutory laws and regulations dealing with the calculation of distributable reserves are open to legal interpretation. Accordingly, in view of the uncertainty surrounding such a calculation, management believes it would be inappropriate to disclose an amount in these notes.

Dividends declared in 1999, in respect of 1998, to holders of ordinary shares and preference shares were RR 0.0062 per ordinary share (1997: RR 0.005 per ordinary share) and RR 0.0152 per preference share (1997: 0.00917 Russian roubles per preference share). Cumulative preference dividends outstanding were RR 4 million as at 31 December 1998.

(in millions of Russian roubles expressed in terms of the purchasing power of the Russian rouble as at 31 December 1998)

Note 12: Shareholders' equity (continued)

On 7 May 1998 the law "On the Peculiarities of Share Distribution of UES" was signed by the President of the Russian Federation. This law stipulates that a minimum of 51.0 percent of voting shares in RAO UES be held by the government of the Russian Federation and that foreign investors are limited to owning not more than 25.0 percent of the voting shares of the company. The practical implications of this foreign ownership limitation for the Company or its shareholders are unclear.

Treasury shares. Treasury shares as at 31 December 1998 represent 351,857,799 ordinary and 935,002 preference shares purchased and held by the Company, at cost.

	31 December 1998
Ordinary shares	247
Preference shares	3
	250

Note 13: Profits tax

The Company is comprised of several separate tax paying subdivisions each of which are subject to profit tax rates of 35% on taxable profits computed in accordance with the Russian tax legislation. Net loss before profit tax for financial reporting purposes is reconciled to tax expenses as follows:

	Year ended 31 December 1998
Loss before taxation	87,061
Theoretical tax benefit at a statutory rate of 35 percent	30,472
Increase/(reduction) due to:	
Income that is not assesable for profits tax purposes	514
Expenses non-deductible for profits tax purposes	(1,026)
Non-temporary elements of monetary gains / losses	(33,295)
Inflation effect on deferred tax balance at beginning of year	9,810
Release of prior year deferred profit tax liability resulting from reorganisation of certain assets (see below)	4,097
Total tax benefit	10,572

The non-temporary impact of monetary gains and losses reflects the taxation charges and benefits arising from the restatement for the effects of inflation of non-monetary assets and liabilities.

Deferred profit tax is calculated on all temporary differences under the liability method using the statutory tax rate of 35 percent.

During 1998 the Company incorporated one of its subdivisions and a number of construction projects into separate legal entities. As part of the consideration for its investment in these new legal entities the Company contributed fixed assets. These fixed assets had an associated deferred profit tax liability as at 1 January 1998. On disposal of the fixed assets as part payment for the equity in the new legal entities the associated deferred profit tax liability became a non-temporary difference since the Company does not intend to sell its investment in these entities. Consequently, a release of RR 4,097 million has been recognised in the deferred profit taxation benefit in 1998.

(in millions of Russian roubles expressed in terms of the purchasing power of the Russian rouble as at 31 December 1998)

Note 13: Profits tax (continued)

Differences between IAS and Russian taxation and reporting regulations give rise to certain temporary differences between the financial statement and tax bases of assets and liabilities. The cumulative effect of such differences is as follows:

Deferred profits tax liability	31 December 1998	Movement for the year	31 December 1997
Trade receivables	(1,814)	(133)	(1,681)
Property, plant and equipment	(7,883)	12,349	(20,232)
Other	(65)	(65)	-
	(9,762)	12,151	(21,913)

Deferred profits tax asset	31 December 1998	Movement for the year	31 December 1997
Accounts payable	86	(3)	89
Other	49	(351)	400
	135	(354)	489
Net deferred profit tax liability	(9,627)	11,797	(21,424)

A net deferred profits tax liability of RR 3,331 million would crystallise on the disposal of long term investments. However, the Company is able to control the timing of the reversal of the temporary difference and it is probable that it will not reverse in the foreseeable future. Consequently, in accordance with IAS 12 (revised 1996), the net deferred profits tax liability has not been recognised.

As a result of the changes in the Russian tax legislation, a profit tax rate of 30% has been enacted starting from 1 April 1999. As this tax rate was not substantively enacted at 31 December 1998, the effect of the change will be reflected in the financial statements for the year ended 31 December 1999. The estimated amount of the change of deferred profit tax liabilities as at 31 December 1998 resulting from the reduction in the tax rate is equal is RR 1,375 million.

Note 14: Non-current debt

	Currency	Interest rate	Due	31 December 1998
Bank debt	US$	20%	1999 onwards	1,576
Bank debt	US$	7%	1999 onwards	27
				1,603
Less: current portion of non-current debt				(710)
Total				893

Maturity Table	31 December 1998
Due for re-payment	
Between one and two years	880
Between two and five years	13
	893

The above debt is unsecured and the majority of it is obtained at a fixed interest rate. It is not practicable to measure the fair value of the above debt.

(in millions of Russian roubles expressed in terms of the purchasing power of the Russian rouble as at 31 December 1998)

Note 15: Current debt and current portion of non-current debt

	Interest rate	31 December 1998
Bank debt	60%	533
Bank debt	7% - 11%	261
Current portion of non-current debt		710
		1,504

The above debt of RR 261 million is secured against certain trade receivable balances and the remainder is unsecured. The debt is obtained at a variable interest rate and it is not practicable to measure the fair value of the above debt.

Note 16: Accounts payable and accrued charges

	31 December 1998
Construction payables	2,801
Trade payables	365
Bills of exchange payable	30
Dividends payable	104
Accrued liabilities and other creditors	2,413
	5,713

The above payables represent the fair value of the underlying obligation. The Company has not paid in full for its interest in Yakutskenergo. The Company is obliged to issue ordinary shares to the Russian Federation in settlement of this liability. The Company has recognised a liability of RR 1,234 million in respect of this, which is the estimated fair value of consideration to be paid and is included within accrued liabilities and other creditors.

In 1998, approximately 93% of the Company's settlements of accounts payable and accrued charges were settled via non-cash settlements.

Note 17: Taxes payable

Taxes payable consists of the following:

	31 December 1998
Value added tax	1,993
Fines and interest	1,531
Turnover taxes	982
Profits tax	402
Property tax	136
Employee taxes	96
Other taxes	258
	5,398

Included within value added tax payable is RR 1,289 million in 1998 for value added tax that is only payable to the tax authorities when the underlying receivable balance is recovered.

(in millions of Russian roubles expressed in terms of the purchasing power of the Russian rouble as at 31 December 1998)

Note 17: Taxes payable (continued)

Included within turnover taxes payable is RR 339 million in 1998 of turnover taxes that are only payable to the tax authorities when the underlying receivable balance is recovered.

In 1998, approximately 50% of the Company's settlements of taxes payable were settled via non-cash settlements.

Note 18: Operating costs

Included within operating costs is depreciation and amortisation of RR 9,553 million and gross staff costs of RR 1,488 million, including approximately RR 417 million of employment and related payroll taxes.

Note 19: Loss per share

Loss per share has been calculated by dividing the net loss for the year attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the year. The net loss attributable to ordinary shareholders is reconciled to the net loss in the year as shown in the table below.

	31 December 1998
Net loss	(76,489)
1998 dividend to preferred shareholders	(32)
Net loss attributable to ordinary shareholders	(76,521)

There were 40.7 billion weighted average shares outstanding for the years ended 31 December 1998 and 31 December 1997.

The basic loss per share above is for RAO UES as a parent company on a stand-alone basis. The loss per share for the RAO UES Group is disclosed in the 1998 RAO UES Group consolidated financial statements.

Note 20: Commitments

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

Capital commitments. Future capital expenditures for which contracts have been signed amount to RR 5,336 million at 31 December 1998.

Note 21: Contingencies

Political environment. The operations and earnings of the Company 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. Due to the capital intensive nature of the industry, the Company is also subject to physical risks of various kinds. The nature and frequency of these developments and events associated with these risks, which generally are not covered by insurance, as well as their effect on future operations and earnings are not predictable. These matters could have material effects on the operations of the Company.

Legal proceedings. The Company 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 Company.

The Company has suspended the building of blocks 2, 3 and 4 for the generating subsidiary referred to as the North-West Station. The contractors and suppliers have commenced legal action against the Company seeking recovery for equipment manufactured equal to RR 137 million. The potential outcome of this is unclear. No provision for any potential costs has been made in the Company financial statements.

Taxation. Due to the presence in Russian commercial legislation, and tax legislation in particular, of provisions allowing more than one interpretation, and also due to the practice developed in a generally unstable environment by the tax authorities of making arbitrary judgement of business activities, Management's judgement of the Company's business activities may not coincide with the interpretation of the same activities by tax authorities. If a particular treatment was to be challenged by the tax authorities, the Company may be assessed additional taxes, penalties and interest, which can be significant. Tax years remain open to review by the tax authorities for six years.

Year 2000 – external factors. It is unclear whether the Russian government and non-government organisations that provide significant infrastructure services have addressed the Year 2000 Problem sufficiently to mitigate potential substantial disruption to these infrastructure services. The substantial disruption of these services would have an adverse effect on the operations of the Company. Furthermore, the current financial crisis (as disclosed in Note 2) could affect the ability of the government and other organisations to fund Year 2000 compliance programs.

Industry changes. The industry is continuing to undergo significant restructuring and reform initiatives and the future direction and effects of reforms are unknown at this time. Potential reforms in tariff setting policies, settlements of outstanding debts by governmental entities, restructuring of operations of the wholesale electricity market and introduction of measures to create competition within the wholesale electricity market could have significant effects on enterprises operating in the industry. Due to the uncertainty concerning the actual changes in the industry which are to be implemented, management is unable to estimate the effects of reforms or the resulting future impact on the financial position of the Company.

Environmental matters. The Company and its 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. The Company periodically evaluates its obligations under environmental regulations. Potential liabilities might arise as a result of changes in legislation and regulation or civil litigation. The impact of these potential changes cannot be estimated but could be material. In the current enforcement climate under existing legislation, management believes that there are no significant liabilities for environmental damage, other than any amounts which have been accrued in the accompanying balance sheet.

Note 22: Financial Instruments

Credit risk. Financial assets which potentially subject the Company 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 Company though the timing of settlements could be affected by economic factors beyond management's control including the uncertainty arising from the recent financial crisis in Russia.

Foreign exchange risk. The Company primarily operates within the Russian Federation. The majority of its purchases are denominated in Russian roubles. Since revenues are primarily denominated in Russian roubles, the Company is exposed to foreign exchange risk which is primarily concentrated in long-term loans of US $77 million (as discussed in Note 14). In accordance with the Company's accounting policies these loans have been translated into RR at the exchange rate prevailing at the balance sheet date.

Interest rate risk. As discussed in Note 14 the majority of interest rates on debt are variable. Interest rates on rouble denominated debt is reset when the underlying Central Bank re-financing rate changes. The Central Bank re-financing rate has fluctuated significantly during the year.

Fair values. Management does not believe it is practicable to estimate the fair value of long-term investments, trade payables and long and short term debt. These financial instruments are not traded in the Russian financial market and an objective fair value is not, therefore, available. Unless otherwise described in the Notes to the financial statements, all balances have been included at their fair value.

Note 23: Significant Post Balance Sheet Events

In June 1999, as part of government initiative, the Company signed a binding agreement "About the stabilisation of economic situation in Russia" together with other major companies in the Russian Federation. This agreement stipulated that members of RAO UES Group would not increase their tariffs by more than 50 percent of the rate of inflation. This agreement is effective for six months to 31 December 1999.

In April 1999 the Company sold 72 percent of its voting shares in Pskovskaya GRES to RAO Gazprom. This sale was in settlement of Pskovenergo GRES's liability for gas supplies. The Company retained 28 percent voting shares in this entity.