

FEDERAL GRID COMPANY UES GROUP
COMBINED AND CONSOLIDATED
FINANCIAL STATEMENTS
PREPARED IN ACCORDANCE WITH
INTERNATIONAL FINANCIAL REPORTING STANDARDS
FOR THE YEAR ENDED 31 DECEMBER 2007

INDEPENDENT AUDITOR'S REPORT

To the Shareholders and the Board of Directors of Open Joint Stock Company «Federal Grid Company of Unified Energy System» (JSC FGC UES):

- 1 We have audited the accompanying combined and consolidated financial statements of JSC FGC UES and its subsidiaries (the Group) which comprise the combined and consolidated balance sheet as at 31 December 2007, combined and consolidated statement of operations, combined and consolidated statement of cash flow and combined and consolidated statement of changes in equity for the year then ended and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

- 3 Our responsibility is to express an opinion on these combined and consolidated financial statements based on our audit. Except as discussed in the paragraphs 6, 7 and 8, we conducted our audit in accordance with International Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.
- 4 An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
- 5 We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Basis for qualified opinion

- 6 The Group has not maintained adequate accounting records regarding the original cost, revalued amounts, depreciation and impairment provision at the level of individual items of property, plant and equipment. As such, it was not practicable to extend our auditing procedures sufficiently to satisfy ourselves as to the carrying amount of individual items of property, plant and equipment of RR 354,040 million and RR 240,911 million included in the accompanying combined and consolidated balance sheet as at 31 December 2007 and 2006, respectively, the related revaluation effects in both the combined and consolidated statement of operations and the combined and consolidated statement of changes in equity, depreciation expenses in the combined and consolidated statements of operations and the related effect on the deferred tax balance.
- 7 As discussed in Note 6 to the combined and consolidated financial statements, the Group's property, plant and equipment have been revalued as at 1 January 2007. The comparative information in relation to property, plant and equipment has not been restated. However, the management performed the previous

AUDITOR'S REPORT

revaluation of property, plant and equipment at 31 December 2001 and since that date up to 1 January 2007 did not assess if the fair values were significantly different from the carrying amounts. This practice, in our opinion, is not in compliance with International Financial Reporting Standards. The carrying amount of such property, plant and equipment as at 31 December 2006 was RR 173,801 million.

- 8 Additionally, for certain subsidiaries where there was no revaluation before 31 December 2006, the comparative information of the Group's property, plant and equipment with the carrying value of RR 67,110 million as at 31 December 2006, is presented as at that date at depreciated cost less impairment. This practice, in our opinion, is not in compliance with International Financial Reporting Standards.

Qualified opinion

- 9 In our opinion, except for the possible effects, if any, on the combined and consolidated financial statements and comparative information of the matters noted in paragraphs 6, 7 and 8 above, the accompanying combined and consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2007, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Emphasis of Matters

- 10 Without further qualifying our opinion, we draw attention to the Note 2 of the accompanying combined and consolidated financial statements. These combined and consolidated financial statements include carved out revenues and expenses of electricity transmission businesses within predecessor legal entities that have other business activities. Because of the various determinations used in carving out such revenues and expenses, as described in Note 2 and elsewhere in these combined and consolidated financial statements, those revenues and expenses related to the electricity transmission operations within predecessor legal entities may not be indicative of revenues expected to be earned and costs expected to be incurred on a prospective basis for the electricity transmission operations within the Group as a separate business and, as such, these combined and consolidated financial statements may not be indicative of future results of operations and trends.
- 11 Without further qualifying our opinion, we draw attention to Notes 1 and 5 to the accompanying combined and consolidated financial statements. The Government of the Russian Federation has an ultimate controlling interest in the Group and governmental economic and social policies affect the Group's financial position, results of operations and cash flows.

ZAO PricewaterhouseCoopers Audit

Moscow, Russian Federation
24 September 2008

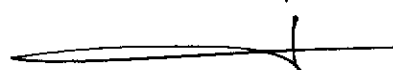
FGC UES Group

Combined and consolidated Balance Sheet as at 31 December 2007
(in millions of Russian Roubles)


	Notes	31 December 2007	31 December 2006
ASSETS			
Non-current assets			
Property, plant and equipment	6	354,040	240,911
Intangible assets	7	4,871	2,469
Investments in associates	8	509	-
Available-for-sale investments	9	-	3,035
Other non-current assets	10	1,057	3,269
Total non-current assets		360,477	249,684
Current assets			
Cash and cash equivalents	11	15,248	6,365
Accounts receivable and prepayments	12	25,139	12,623
Inventories	13	2,230	1,536
Available-for-sale investments	9	3,035	-
Other current assets		332	568
Total current assets		45,984	21,092
TOTAL ASSETS		406,461	270,776
EQUITY AND LIABILITIES			
Equity			
Share capital: Ordinary shares	14	180,691	121,607
Revaluation reserve	6	40,073	-
Merger reserve	14	(15,121)	(6,394)
Foreign currency translation reserve	8	(14)	-
Retained earnings		39,450	34,587
Equity attributable to shareholders of FGC UES		245,079	149,800
Minority interest	14	27,019	21,062
Total equity		272,098	170,862
Non-current liabilities			
Deferred profit tax liabilities	15	31,534	15,800
Non-current debt	16	-	25,448
Pension obligations	17	2,516	2,661
Total non-current liabilities		34,050	43,909
Current liabilities			
Accounts payable to shareholders of FGC UES	14	47,405	34,338
Current debt and current portion of non-current debt	18	30,489	10,255
Accounts payable and accrued charges	19	21,958	10,986
Taxes payable	20	461	426
Total current liabilities		100,313	56,005
Total liabilities		134,363	99,914
TOTAL EQUITY AND LIABILITIES		406,461	270,776

23 September 2008

Deputy Chairman of the Management Board

 A.A. Demin

Chief Accountant

 V.V. Shchukin

The accompanying notes on pages 6 to 38 are an integral part of these combined and consolidated financial statements

FGC UES Group

Combined and Consolidated Statement of Operations for the year ended 31 December 2007
(in millions of Russian Roubles)

	Notes	31 December 2007	31 December 2006
Revenues	21	63,846	57,026
Operating expenses	22	(51,782)	(44,031)
Reversal of impairment provision for property, plant and equipment	6	3,274	26,736
Impairment of property, plant and equipment	6	(1,370)	(522)
Revaluation loss	6	(6,640)	-
Operating profit		7,328	39,209
Interest income		1,523	309
Finance cost	23	(2,751)	(1,985)
Share of (loss) profit of associates	8	1	-
Profit before profit tax		6,101	37,533
Total profit tax charge	15	(2,321)	(9,817)
Profit for the period		3,780	27,716
Attributable to Shareholders of FGC UES		5,526	19,911
Minority interest		(1,746)	7,805
Earning per ordinary share for profit attributable to the shareholders of FGC UES – basic and diluted (in Russian Roubles)	24	0.02	0.06

23 September 2008

Deputy Chairman of the Management Board


A.A. Demin

Chief Accountant


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FGC UES Group

Combined and Consolidated Cash Flow Statement for the year ended 31 December 2007
(in millions of Russian Roubles)


	Notes	31 December 2007	31 December 2006
CASH FLOWS FROM OPERATING ACTIVITIES:			
Profit before profit tax		6,101	37,533
<i>Adjustments to reconcile profit before profit tax to net cash provided by operations</i>			
Impairment of investment in associate	22	241	-
Depreciation of property, plant and equipment	22	13,060	9,723
Amortisation of intangible assets	22	548	196
Reversal of impairment provision for property, plant and equipment	6	(3,274)	(26,736)
Impairment of property, plant and equipment	6	1,370	522
Revaluation loss	6	6,640	-
Loss on disposal of property, plant and equipment	22	909	321
(Reversal)/accrual of bad debt provision	22	(268)	1,345
Interest income		(1,523)	(309)
Interest expense (debt)	23	2,700	1,960
Interest expense (discount), net	23	51	25
Other non-cash transactions		(257)	(44)
Operating cash flows before working capital changes and profit tax paid		26,298	24,536
<i>Working capital changes:</i>			
Increase in accounts receivable and prepayments		(12,248)	(3,591)
Decrease in other current assets		236	423
Increase in inventories		(694)	(144)
Decrease in other non-current assets		2,161	343
Increase in accounts payable and accrued charges		10,972	2,315
Increase/(decrease) in taxes payable, other than profit tax		70	(312)
(Decrease)/increase in pension obligations		(145)	378
Profit tax paid		(1,718)	(1,887)
Net cash from operating activities		24,932	22,061
CASH FLOWS FROM INVESTING ACTIVITIES:			
Additions to property, plant and equipment		(68,934)	(29,538)
Additions to intangible assets		(2,950)	(1,572)
Purchase of investments	4	(206)	(2,000)
Interest received		1,523	309
Net cash used in investing activities		(70,567)	(32,801)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from issuance of ordinary shares	14	62,868	3,045
Proceeds from issuance of current debt		22,015	3,450
Proceeds from issuance of non-current debt		-	16,000
Repayment of loans		(27,000)	(5,089)
Dividends paid		(690)	(372)
Interest paid		(2,675)	(1,754)
Net cash used in financing activities		54,518	15,280
Net increase in cash and cash equivalents		8,883	4,540
Cash and cash equivalents at the beginning of the period	11	6,365	1,825
Cash and cash equivalents at the end of the period	11	15,248	6,365

23 September 2008

Deputy Chairman of the Management Board

 A.A. Demin

Chief Accountant

 V.V. Shchukin

The accompanying notes on pages 6 to 38 are an integral part of these combined and consolidated financial statements

FGC UES Group

Combined and Consolidated Statement of Changes in Equity for the year ended 31 December 2007
(in millions of Russian Roubles)

	Notes	Attributable to shareholders of FGC UES						Total equity	
		Ordinary share capital	Merger reserve	Revaluation reserve	Foreign currency translation reserve	Retained earnings	Total		Minority interest
As at 1 January 2006		121,607	23,313	-	-	15,105	160,025	13,257	173,282
Profit for the period		-	-	-	-	19,911	19,911	7,805	27,716
Total recognised income for the year		-	-	-	-	19,911	19,911	7,805	27,716
Distribution to RAO UES		-	57	-	-	(57)	-	-	-
Change in Group structure	14	-	(29,764)	-	-	-	(29,764)	-	(29,764)
Dividends	14	-	-	-	-	(372)	(372)	-	(372)
As at 31 December 2006		121,607	(6,394)	-	-	34,587	149,800	21,062	170,862
As at 1 January 2007		121,607	(6,394)	-	-	34,587	149,800	21,062	170,862
Effects of revaluation of property, plant and equipment	6	-	-	40,073	-	-	40,073	7,730	47,803
Foreign currency translation difference	8	-	-	-	(14)	-	(14)	-	(14)
Net income recognised directly in equity		-	-	40,073	(14)	-	40,059	7,730	47,789
Profit for the period		-	-	-	-	5,526	5,526	(1,746)	3,780
Total recognised income for the year		-	-	40,073	(14)	5,526	45,585	5,984	51,569
Change in Group structure	14	-	(8,727)	-	-	-	(8,727)	-	(8,727)
Issue of share capital	14	59,084	-	-	-	-	59,084	-	59,084
Dividends	14	-	-	-	-	(663)	(663)	(27)	(690)
As at 31 December 2007		180,691	(15,121)	40,073	(14)	39,450	245,079	27,019	272,098

23 September 2008

Deputy Chairman of the Management Board

Chief Accountant

 A.A. Demin
 V.V. Shchukin

The accompanying notes on pages 6 to 38 are an integral part of these combined and consolidated financial statements

FGC UES Group

Notes to the Combined and Consolidated Financial Statements for the year ended 31 December 2007
(in millions of Russian Roubles)

Note 1. The Group and its operations

Open Joint Stock Company "Federal Grid Company of Unified Energy System" ("FGC UES" or "the Company") was established on 25 June 2002 as a wholly-owned subsidiary of the Russian Open Joint Stock Company for Energy and Electrification United Energy System of Russia ("RAO UES") as a result of implementing the decisions of the Board of Directors of RAO UES dated 25 January 2002 and 7 May 2002 in accordance with the Russian Government Resolution No. 526 "Electric Utilities Reform in the Russian Federation" dated 11 July 2001.

RAO UES itself was created as the holder of certain significant electricity power generation, transmission and distribution assets during the industry privatization in 1992.

The Company was established in the course of the Russian electric utilities industry restructuring, discussed further below, to maintain and operate the high voltage electricity transmission network, received or earmarked for receipt from RAO UES and its subsidiaries, and to provide electricity transmission services using that network.

In 2002 and 2003 the assets of the transmission business (the high voltage network and related assets under construction) belonging to RAO UES were transferred to the Company by RAO UES as a contribution to the share capital of the Company.

As at 31 December 2007 the FGC UES Group (the "Group") comprises FGC UES and its subsidiaries presented in Note 4, including 50 transmission companies (see also Sector restructuring).

The Group's primary activity is the provision of services for the transmission of electric power via the Unified National Electrical Network (UNEN).

As at 31 December 2007 the number of employees of the Group was approximately 23 thousand (31 December 2006: approximately 20 thousand).

The registered office of the Company is located at 5a, Academician Chelomey Str., 117630, Moscow, Russia.

The Group is considered by management to have a single activity, i.e. the provision of electricity transmission services within the Russian Federation, and this activity comprises one industry and one geographic segment. Other activities do not result in significant revenues, assets or liabilities and do not constitute reportable segments as defined by International Accounting Standard 14 "Segment reporting".

Relations with the state. At 31 December 2007 the state owned 12.44 per cent of the voting ordinary shares of the Company and 52.68 per cent of RAO UES who, in its turn, owned 87.56 per cent of the voting ordinary shares of the Company. The Government of the Russian Federation ("RF") is the ultimate controlling party of the Company.

The RF directly affects the Group's operations through regulation by the Federal Tariff Service (FTS).

The investment program of FGC UES is subject to approval by the Ministry of Industry and Electricity and FST.

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

Sector restructuring and FGC UES reorganisation. Over a period of years the Russian electric utilities industry underwent a reform process designed to introduce competition into the electricity sector and to create an environment in which RAO UES and its successor companies could raise the capital required to maintain and expand current capacity.

The regulatory framework governing the process of reforming the Russian Federation electric utilities industry and the functioning of the industry, both during the transition period and subsequent to the completion of reforms, is set forth in the following legislation: Federal Law No.35-FZ of 26 March 2003 "On Electric Utilities" and Federal Law No.36-FZ of 26 March 2003 "On the Specifics of the Functioning of Electric Utilities During the Transition Period" and the Introduction of Amendments to Certain Russian Federation Legislative Acts and the Invalidation of Certain Russian Federation Legislative Acts in Connection with the Adoption of the Law "On the Electric Utilities of the Russian Federation".

The reform assumed changes in the industry structure with the separation of natural monopoly activities (power transmission, dispatching) from potentially competitive ones (electric power production, supply). The result of the reorganisation of RAO UES is that generation and retailing companies entered the private sector for the most part and will operate in a competitive market. Government control will continue in natural monopoly areas within the industry.

FGC UES Group

Notes to the Combined and Consolidated Financial Statements for the year ended 31 December 2007
(in millions of Russian Roubles)

Note 1. The Group and its operations (continued)

The formation of the transmission companies (TCs), which were formed on the basis of transmission businesses of the regional electric and heat companies (Energos) during the reform, was completed in 2007.

As at 31 December 2007 RAO UES had transferred to FGC UES the shares of 50 TCs (Note 4), of which 42 TCs were transferred during 2006 and eight TCs were transferred in 2007.

In October 2007 the Extraordinary Shareholders' Meeting of RAO UES approved the basic structure for the second (final) phase of RAO UES reorganisation which assumed that in 2008 RAO UES would cease its independent activities and be merged into FGC UES (Note 28).

In December 2007 the Extraordinary Shareholders' Meeting of FGC UES approved the reorganisation of FGC UES (Note 28).

Note 2. Basis of preparation

Statement of compliance. These combined and consolidated financial statements ("Financial Statements") have been prepared in accordance with, and comply with, International Financial Reporting Standards ("IFRS").

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

Reclassification. A RR 2,555 million of property plant and equipment was reclassified as at 31 December 2006 between the categories "Power transmission grids" and "Substations" (Note 6).

Functional and presentation currency. The national currency of the Russian Federation is the Russian Rouble (RR), which is FGC UES's functional currency and the currency in which these Financial Statements are presented. All financial information presented in RR has been rounded to the nearest million.

Predecessor accounting. The changes in the Group structure are described in Note 1. In these financial statements the Group accounted for the merger with the TCs as transactions amongst entities under common control under an accounting policy using the predecessor values method. Accordingly, assets and liabilities of the contributed entities were combined from the earliest period presented and accounted for at the carrying value, as determined by RAO UES in its IFRS consolidated financial statements. Information in respect of the comparative period and opening balances as at 1 January 2006 has been restated as if the business combination took place at the beginning of the earliest period presented. The weighted average number of shares in issue was also calculated in accordance with the predecessor method of accounting (Note 24).

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

Minority interest of the Group includes the proportional share of the subsidiaries' equity held by owners other than RAO UES and the results of operations up to the date of merger of the subsidiary with the Group.

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

New accounting developments. These Financial Statements have been prepared by applying the accounting policies consistent with those of the annual financial statements for the year ended 31 December 2006, except for those policies which were changed to comply with the new or amended standards and interpretations that are in force for the year beginning on 1 January 2007.

These new or amended standards and interpretations that are in force for the year beginning on 1 January 2007 and their impact on the current period or any prior period is described below:

FGC UES Group

Notes to the Combined and Consolidated Financial Statements for the year ended 31 December 2007
(in millions of Russian Roubles)

Note 2. Basis of preparation (continued)

- IFRIC 7, "Applying the Restatement Approach under IAS 29", effective for annual periods beginning on or after 1 March 2006. This amendment did not have a material effect on the Group's financial statements;
- IFRIC 8, "Scope of IFRS 2", effective for annual periods beginning on or after 1 May 2006. This amendment did not have a material effect on the Group's financial statements;
- IFRIC 9, "Reassessment of Embedded Derivatives", effective for annual periods beginning on or after 1 June 2006. This amendment did not have a material effect on the Group's financial statements;
- IFRIC 10, "Interim financial reporting and impairment", effective for annual periods beginning on or after 1 November 2006. This amendment did not have a material effect on the Group's financial statements;
- IFRIC 11, "IFRS 2 - Group and Treasury share transactions", effective for annual periods beginning on or after 1 March 2007. This amendment did not have a material effect on the Group's financial statements; and
- IFRS 7, "Financial instruments: Disclosures", effective for annual periods beginning on or after 1 January 2007. IAS 1, "Amendments to capital disclosures", effective for annual periods beginning on or after 1 January 2007. IFRS 7 introduces new disclosures to improve the information disclosed about financial instruments. The Amendment to IAS 1 introduces disclosures about the level of an entity's capital and how it manages capital. The Group has adopted IFRS 7 and the amendment to IAS 1 starting from 1 January 2007.

The following new standards, amendments to standards and interpretations have been issued but are not effective for 2007 and have not been early adopted:

- IFRS 8, Operating Segments (effective for annual periods beginning on or after 1 January 2009). The Standard applies to entities whose debt or equity instruments are traded in a public market or that file, or are in the process of filing, their financial statements with a regulatory organisation for the purpose of issuing any class of instruments in a public market. IFRS 8 requires an entity to report financial and descriptive information about its operating segments and specifies how an entity should report such information. The Group is assessing the impact of the amended standard on its financial statements.
- Puttable financial instruments and obligations arising on liquidation — IAS 32 and IAS 1 Amendment (effective from 1 January 2009). The amendment requires classification as equity of some financial instruments that meet the definition of a financial liability. The Group does not expect the amendment to affect its consolidated financial statements.
- IAS 23, Borrowing Costs (revised March 2007; effective for annual periods beginning on or after 1 January 2009). The main change to IAS 23 is the removal of the option of immediately recognising as an expense borrowing costs that relate to assets that take a substantial period of time to get ready for use or sale. An entity is, therefore, required to capitalise such borrowing costs as part of the cost of the asset. The revised standard applies prospectively to borrowing costs relating to qualifying assets for which the commencement date for capitalisation is on or after 1 January 2009. The Group is currently assessing the impact of the amended standard on its financial statements. In these Financial Statements all borrowing costs are expenses in the period in which they are incurred.
- IAS 1, Presentation of Financial Statements (revised September 2007; effective for annual periods beginning on or after 1 January 2009). The main change in IAS 1 is the replacement of the income statement by a statement of comprehensive income which will also include all non-owner changes in equity, such as the revaluation of available-for-sale financial assets. Alternatively, entities will be allowed to present two statements: a separate income statement and a statement of comprehensive income. The revised IAS 1 also introduces a requirement to present a statement of financial position (balance sheet) at the beginning of the earliest comparative period whenever the entity restates comparatives due to reclassifications, changes in accounting policies, or corrections of errors. The Group expects the revised IAS 1 to affect the presentation of its financial statements but to have no impact on the recognition or measurement of specific transactions and balances.

Note 2. Basis of preparation (continued)

- IAS 27, Consolidated and Separate Financial Statements revised January 2008; effective for annual periods beginning on or after 1 July 2009). The revised IAS 27 will require an entity to attribute total comprehensive income to the owners of the parent and to the non-controlling interests (previously "minority interests") even if this results in the non-controlling interests having a deficit balance (the current standard requires the excess losses to be allocated to the owners of the parent in most cases). The revised standard specifies that changes in a parent's ownership interest in a subsidiary that do not result in the loss of control must be accounted for as equity transactions. It also specifies how an entity should measure any gain or loss arising on the loss of control of a subsidiary. At the date when control is lost, any investment retained in the former subsidiary will have to be measured at its fair value. The Group does not expect IAS 27 to affect the consolidated financial statements.
- IFRS 3, Business Combinations (revised January 2008; effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009). The revised IFRS 3 will allow entities to choose to measure non-controlling interests using the existing IFRS 3 method (proportionate share of the acquiree's identifiable net assets) or at fair value. The revised IFRS 3 is more detailed in providing guidance on the application of the purchase method to business combinations. The requirement to measure at fair value every asset and liability at each step in a step acquisition for the purposes of calculating a portion of goodwill has been removed. Instead, goodwill will be measured as the difference at acquisition date between the fair value of any investment in the business held before the acquisition, the consideration transferred and the net assets acquired. Acquisition-related costs will be accounted for separately from the business combination and therefore recognised as expenses rather than included in goodwill. An acquirer will have to recognise at the acquisition date a liability for any contingent purchase consideration. Changes in the value of that liability after the acquisition date will be recognised in accordance with other applicable IFRSs, as appropriate, rather than by adjusting goodwill. The revised IFRS 3 brings into its scope business combinations involving only mutual entities and business combinations achieved by contract alone. The Group will apply IFRS 3 (Revised) prospectively to all business combinations from 1 January 2010.
- Vesting Conditions and Cancellations—Amendment to IFRS 2, Share-based Payment (issued in January 2008; effective for annual periods beginning on or after 1 January 2009). The amendment clarifies that only service conditions and performance conditions are vesting conditions. Other features of a share-based payment are not vesting conditions. The amendment specifies that all cancellations, whether by the entity or by other parties, should receive the same accounting treatment. The Group does not expect Amendment to IFRS 2, Share-based Payment to affect the consolidated financial statements.
- IFRIC 13, Customer Loyalty Programmes (issued in June 2007; effective for annual periods beginning on or after 1 July 2008). IFRIC 13 clarifies that where goods or services are sold together with a customer loyalty incentive (for example, loyalty points or free products), the arrangement is a multiple-element arrangement and the consideration receivable from the customer is allocated between the components of the arrangement using fair values. IFRIC 13 is not relevant to the Group's operations because no Group companies operate any loyalty programmes.
- IFRIC 15, Agreements for the Construction of Real Estate (effective for annual periods beginning on or after 1 January 2009). The interpretation applies to the accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors, and provides guidance for determining whether agreements for the construction of real estate are within the scope of IAS 11 or IAS 18. It also provides criteria for determining when entities should recognise revenue on such transactions. The Group does not expect IFRIC 15 to affect its consolidated financial statements.
- IFRIC 16, Hedges of a Net Investment in a Foreign Operation (effective for annual periods beginning on or after 1 October 2008). The interpretation explains which currency risk exposures are eligible for hedge accounting and states that translation from the functional currency to the presentation currency does not create an exposure to which hedge accounting could be applied. The IFRIC allows the hedging instrument to be held by any entity or entities within a group except the foreign operation that itself is being hedged. The interpretation also clarifies how the gain or loss recycled from the currency translation reserve to profit or loss is calculated on disposal of the hedged foreign operation. Reporting entities will apply IAS 39 to discontinue hedge accounting prospectively when their hedges do not meet the criteria for hedge accounting in IFRIC 16. IFRIC 16 does not have an impact on these consolidated financial statements as the Group does not apply hedge accounting.

Note 2. Basis of preparation (continued)

- Improvements to International Financial Reporting Standards (issued in May 2008). In 2007, the International Accounting Standards Board decided to initiate an annual improvements project as a method of making necessary, but non-urgent, amendments to IFRS. The amendments issued in May 2008 consist of a mixture of substantive changes, clarifications, and changes in terminology in various standards. The substantive changes relate to the following areas: classification as held for sale under IFRS 5 in case of a loss of control over a subsidiary; possibility of presentation of financial instruments held for trading as non-current under IAS 1; accounting for sale of IAS 16 assets which were previously held for rental and classification of the related cash flows under IAS 7 as cash flows from operating activities; clarification of definition of a curtailment under IAS 19; accounting for below market interest rate government loans in accordance with IAS 20; making the definition of borrowing costs in IAS 23 consistent with the effective interest method; clarification of accounting for subsidiaries held for sale under IAS 27 and IFRS 5; reduction in the disclosure requirements relating to associates and joint ventures under IAS 28 and IAS 31; enhancement of disclosures required by IAS 36; clarification of accounting for advertising costs under IAS 38; amending the definition of the fair value through profit or loss category to be consistent with hedge accounting under IAS 39; introduction of accounting for investment properties under construction in accordance with IAS 40; and reduction in restrictions over manner of determining fair value of biological assets under IAS 41. Further amendments made to IAS 8, 10, 18, 20, 29, 34, 40, 41 and to IFRS 7 represent terminology or editorial changes only, which the IASB believes have no or minimal effect on accounting.
- Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate—IFRS 1 and IAS 27 Amendment (revised May 2008; effective for annual periods beginning on or after 1 January 2009). The amendment allows first-time adopters of IFRS to measure investments in subsidiaries, jointly controlled entities or associates at fair value or at previous GAAP carrying value as deemed cost in the separate financial statements. The amendment also requires distributions from pre-acquisition net assets of investees to be recognised in profit or loss rather than as a recovery of the investment. The amendments will not have an impact on the Group's consolidated financial statements.
- Eligible Hedged Items - Amendment to IAS 39, Financial Instruments: Recognition and Measurement (effective with retrospective application for annual periods beginning on or after 1 July 2009, with earlier application permitted). The amendment clarifies how the principles that determine whether a hedged risk or portion of cash flows is eligible for designation should be applied in particular situations. The amendment is not expected to have an impact on the Group's consolidated financial statements.
- IFRIC 12, Service Concession Arrangements (effective for annual periods beginning on or after 1 January 2008). This interpretation applies to companies that participate in service concession arrangements and provides guidance on the accounting by operators in public-to-private service concession arrangements. We do not expect IFRIC 12 to have material impact on the Group's accounts.
- IFRIC 14, IAS 19—The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction (effective for annual periods beginning on or after 1 January 2008). This interpretation is not expected to have an impact on the Group's consolidated financial statements.

Going concern. These Financial Statements have been prepared on a going concern basis, which contemplates the realisation of assets and the satisfaction of liabilities in the normal course of business. The accompanying Financial Statements do not include any adjustments that might be necessary, should the Group be unable to continue as a going concern.

As at 31 December 2007 the Group's current liabilities exceeded its current assets by RR 54,320 million (as at 31 December 2006 RR 34,913 million). The change in the current financial position in 2007 is partially explained by a significant reclassification of long-term loans in the amount of RR 18,000 million into current liabilities (Note 16). As discussed in Note 28 "Reclassification of non-current debts", in connection with the reorganisation of FGC UES approved by the shareholders in December 2007, the Company notified its creditors of their right to demand the settlement of liabilities. In this circumstance, in accordance with IAS 1 "Presentation of Financial Statements", the related liabilities in the amount as at 31 December 2007 of RR 18,000 million should be presented as current liabilities as FGC UES did not have an unconditional right to defer the settlement of the liabilities for at least 12 months after the balance sheet date. The Company's creditors had the right to make a claim within 30 days from the date of their notification. The claims received from the creditors up to the date of expiry of the notification period amounted to RR 70 million; the remaining amount of FGC UES non-current debt was reclassified back to non-current liabilities on expiry of the notification period.

FGC UES Group

Notes to the Combined and Consolidated Financial Statements for the year ended 31 December 2007
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Note 2. Basis of preparation (continued)

Furthermore, as at 31 December 2007 the Group had an unregistered share issue for RR 47,405 million (as at 31 December 2006: RR 34,338 million), which was classified as a current liability to the shareholders (Note 14). The share issues were classified as equity upon their completion and registration in 2008 and 2007, respectively.

Critical accounting estimates and assumptions. Management has made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare these Financial Statements in conformity with IFRS. Estimates and judgments are continually evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Management also makes certain judgements, apart from those involving preparation of estimations, in the process of applying the accounting policies. Judgements that have the most significant effect on the amounts recognised in the financial statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities within the next financial year include:

Property, plant and equipment. The fair value of property, plant and equipment and the remaining useful life were established by an independent valuer as at 1 January 2007 as part of a revaluation. The carrying amount and depreciation of property, plant and equipment are affected by assumptions on the replacement cost, depreciated replacement cost, grouping of individual assets and remaining useful life. Actual results may be different from these estimates (Note 6).

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

Actual results may differ from the estimates and the Group's estimates can be revised in the future, either negatively or positively, depending upon the outcome or expectations based on the facts surrounding each exposure.

As a result of changes in market conditions (Note 1), in the year ended 31 December 2006 the Group identified that the recoverable amount of the Group's property, plant and equipment had significantly changed. Consequently, the previously recognised impairment in the net amount of RR 26,214 million was reversed as at 31 December 2006 (Note 6).

A further reversal of impairment as at 1 January 2007 in the amount of RR 3,274 million was recognised as a consequence of recognising the results of the property, plant and equipment revaluation; similarly, a revaluation loss was recognized in the amount of RR 6,640 million (Note 6).

Pension obligations. Post-employment benefits are generally provided for by plans which are classified and accounted for as defined benefit plans. The present value of defined post-employment benefit obligations and related current service cost are determined in accordance with actuarial valuations, which rely on demographic and financial assumptions including mortality, both during and after employment, rates of employee turnover, discount rate, future salary and benefit levels and, to a limited extent, expected return on plan assets. Actual results may differ from the estimates and the Group's estimates can be revised in the future, either negatively or positively, depending upon the outcome or expectations based on the facts surrounding each exposure.

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

Carve-out methodologies. These combined and consolidated financial statements include carved-out financial statement data of 6 TCs for the period as outlined in the table below:

Transmission company	Predecessor legal entity	Period requiring carve-out accounting
JSC "The Kuban Trunk Grids"	Kubanenergo	8 months ended 31 August 2006
JSC "The Kurgan Transmission Company"	Kurganenergo	6 months ended 30 June 2006
JSC "The Kuzbassenergo Electricity Trunk Grids"	Kuzbassenergo	6 months ended 30 June 2006
JSC "The Electricity Trunk Grids of Komi Republic"	Komienergo	6 months ended 30 June 2006
JSC "The Samara Transmission Company"	Samaraenergo	3 months ended 31 March 2006
JSC "The Saratov Transmission Company"	Saratovenergo	3 months ended 31 March 2006

FGC UES Group

Notes to the Combined and Consolidated Financial Statements for the year ended 31 December 2007
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Note 2. Basis of preparation (continued)

The main activity of the TCs after their incorporation is renting out their transmission assets to ITC Centre (Note 5). In carving out the data of the TCs financial statements, the following determinations were made:

- Revenue is based on actual rental income for the period after incorporation until 31 December 2006;
- Operating expenses are based on actual operating expenses for the period after carve-out;
- Depreciation of property, plant and equipment was calculated based on IFRS estimated predecessor values;
- Current profit tax was determined using the effective profit tax rate of the predecessor entities;
- Deferred profit tax was determined from movements in deferred tax assets/liabilities between 1 January 2006 and the date of establishment of the TCs as stand-alone legal entities;
- Property, plant and equipment were based on the IFRS estimated predecessor values as at the spin-off date;
- Accounts receivable, inventories, accounts payable, taxes payable were taken equal to their values at the spin-off date.

The results of operations of the subsidiaries for the period from 1 January 2006 up to the date of carve-out are recorded in equity as a distribution to RAO UES.

Note 3. Summary of significant accounting policies

Principles of consolidation. The Financial Statements comprise the financial statements of FGC UES and the financial statements of those entities whose operations are controlled by FGC UES. Control is presumed to exist when FGC UES controls, directly or indirectly, through subsidiaries, more than 50 percent of voting rights. The Group consolidates a number of companies in which the Group owns less than 50 percent of the voting shares. In these circumstances, control exists on the basis of a significant shareholding combined with other factors which allow the Group to exercise control, most importantly: FGC UES has appointed the majority or all of the members of the Board of Directors, FGC UES is the dominant owner and FGC UES has in substance full control of all aspects of the entities assets and operations. The majority of the subsidiary companies described in Note 4 were formed during the reorganisation of the Energy system and were transferred to the Group by RAO UES. These transfers represent a reorganisation of entities under common control.

All inter-company balances and transactions have been eliminated. The minority interest in the Group subsidiaries has been disclosed as part of the Group's equity.

Transfers of subsidiaries between entities under common control. Transfers of businesses between parties under common control are accounted for using the predecessor basis of accounting method. Under this method the financial statements of the combined entity are presented as if the businesses had been combined from the beginning of the earliest period presented. The assets and liabilities of the subsidiaries transferred under common control are recognised at the predecessor entity's carrying amounts. Any difference between the carrying amount of net assets and the nominal value of share capital contributed is accounted for in these Financial statements as an adjustment to equity.

Investments in associates. Investments in associates are accounted for using the equity method of accounting that is based upon the percentage of ownership held by the Group. Associated enterprises are entities over which FGC UES is presumed to exercise significant influence but which it does not control. The Group discontinues the use of the equity method of accounting from the date when it ceases to have significant influence in the associate. When the Group's share of losses in an associate equals or exceeds its investment in the associate, including any other unsecured receivables that, in substance, form part of the investment in the associate, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

Unrealised profits resulting from transactions with associates are eliminated to the extent of the Group's interest in these entities.

Goodwill. Goodwill is recognised on acquisitions of subsidiaries and associates. Goodwill arising on the acquisitions represents any excess of the purchase consideration over the acquirer's interest in the net fair value of identifiable assets, liabilities and contingent liabilities. Goodwill is recognised at cost less impairment losses. The carrying amount of goodwill is assessed for impairment on an annual basis. In respect of associates the carrying amount of goodwill is included in the carrying amount of the investment. Any excess of the fair value of the net identifiable assets acquired over the cost of acquisition is recognised immediately in the statement of operations.

Note 3. Summary of significant accounting policies (continued)

Investments. 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 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. 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. 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, if any.

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

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

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

As at 31 December 2007, the official rate of exchange as determined by the Central Bank of the Russian Federation, between the Russian Rouble and the US Dollar ("US\$") was RR 24.55:US\$ 1.00 (31 December 2006 – RR 26.33:US\$ 1.00); between the Russian Rouble and Euro: RR 35.93:Euro 1.00 (31 December 2006 RR 34.70:Euro 1.00).

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

Property, plant and equipment. Property, plant and equipment are stated at revalued amounts less any subsequent accumulated depreciation and any subsequent accumulated impairment losses, where required.

Property, plant and equipment are subject to revaluation on a regular basis to ensure that the carrying amount does not differ materially from that which is determined using the fair value at the balance sheet date. The frequency of revaluation depends upon the movements in the fair values of the assets being revalued. Increases in the carrying amount arising on revaluation of property, plant and equipment are credited to the revaluation reserve in equity; the increase is recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss. Decreases are charged against revaluation reserve directly in equity to the extent they offset previous increases of the same asset recognised in revaluation reserve; all other decreases are charged to the statement of operations. Any accumulated depreciation at the date of revaluation is eliminated against the gross amount of the assets, and the net amount is restated to the revalued amount of the asset.

The revaluation reserve in equity in respect of an item of property, plant and equipment is transferred directly to retained earnings when the item is derecognised (on the retirement or disposal of the asset).

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

Depreciation on property, plant and equipment is calculated on a straight-line basis over the estimated useful life of the asset when it is available for use. The useful lives, in years, of assets by type of facility are as follows:

FGC UES Group

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Note 3. Summary of significant accounting policies (continued)

	Useful lives
Buildings	25-60
Electric power transmission grids	30-50
Substations	30-35
Other	5-15

The Group annually reviews the remaining useful lives by groups of facilities. The average remaining useful lives, in years, of assets by type of facility are as follows:

	The average remaining useful lives in years	
	1 January 2007	1 January 2006
Buildings	41	23
Electric power transmission grids	31	22
Substations	17	18
Other	7	6

At each reporting date the management assess whether there is any indication of impairment of property, plant and equipment. If any such indication exists, the management estimates the recoverable amount, which is determined as the higher of an asset's fair value less costs to sell and its value in use. The carrying amount is reduced to the recoverable amount and the impairment loss is recognised in the statement of operations to the extent it exceeds the previous revaluation surplus in equity on the same asset. An impairment loss recognised for an asset in prior years is reversed if there has been a change in the estimates used to determine the asset's value in use or fair value less costs to sell.

Intangible assets. All of the Company's intangible assets have definite useful lives and primarily include capitalised computer software and licences.

Acquired computer software and licences are capitalised on the basis of the costs incurred to acquire and bring them to use. After initial recognition, intangible assets are carried at cost less accumulated amortisation and any accumulated impairment losses. Amortisation of intangible assets is calculated on a straight-line basis over the useful lives.

At each reporting date the management assesses whether there is any indication of impairment of intangible assets. If impaired, the carrying amount of intangible assets is written down to the higher of value in use and fair value less cost to sell.

Research costs are recognised as an expense as incurred. Costs incurred on development projects are recognised as intangible assets only when the Company can demonstrate the technical feasibility of completing the intangible asset so that it will be available for use or sale, its intention to complete and its ability to use or sell the asset, how the asset will generate future economic benefits, the availability of resources to complete and the ability to measure reliably the expenditure incurred during the development. Other development expenditures are recognised as an expense as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period. The carrying value of development costs is reviewed for impairment annually.

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

Accounts receivable and prepayments. Accounts receivable are recorded inclusive of value added tax (VAT). Accounts receivable are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method less provision for impairment. Such an allowance for doubtful debtors is established if there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of the receivables. The amount of the allowance is the difference between the carrying amount and the recoverable amount, being the present value of expected cash flows, discounted at the market rate of interest for similar borrowers at the date of origination of the receivables.

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

Note 3. Summary of significant accounting policies (continued)

the debtor, including VAT. The related deferred VAT liability is maintained until the debtor is written off for tax purposes.

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

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

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

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

Deferred income tax is provided on post acquisition retained earnings and other post acquisition movements in reserves of subsidiaries, except where the Group controls the subsidiary's dividend policy and it is probable that the difference will not reverse through dividends or otherwise in the foreseeable future.

Accounts payable and accrued charges. Accounts payable are stated inclusive of value added tax. Trade payables are accrued when the counterparty performed its obligations under the contract and are carried at amortised cost using the effective interest method.

Provisions. Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event; it is probable that any outflow of resources embodying economic benefits will be required to settle the obligation and the amount of the obligation can be estimated reliably.

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

Pension and post-employment benefits. In the normal course of business the Group contributes to the Russian Federation defined contribution state pension scheme on behalf of its employees. Mandatory contributions to the governmental pension scheme are expensed when incurred and included in employee benefit expenses and payroll taxes in the statement of operations.

The Group operates defined benefit plans that cover the significant part of the Group's employees. These benefit plans define the amount of pension benefits that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and compensation. The liability recognised in the balance sheet in respect of the defined benefit pension plans is the present value of the defined benefit obligation at the balance sheet date less the fair value of plan assets, together with adjustments for unrecognised actuarial gains or losses. The defined benefit obligations are calculated using the projected unit credit method. The present value of the defined benefit obligations are determined by discounting the estimated future cash outflows using interest rate of government bonds that have terms to maturity approximating the terms of the related pension liabilities.

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

FGC UES Group

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Note 3. Summary of significant accounting policies (continued)

Actuarial gains and losses and post service cost related to long-term employee benefits other than pension scheme are recognised in the statement of operations in the period when they arise.

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

Minority interest. Minority interest represents the minority shareholders' proportionate share of the equity and results of operations of the Group's subsidiaries. This has been calculated based upon the minority interests' ownership percentage of these subsidiaries. Specific rights on liquidation for preference shareholders of subsidiaries are included in the calculation of minority interests. The Group uses the 'economic entity' approach to the recognition of minorities, whereby minorities are treated as equity participants in the Group. As a consequence, any gains or losses resulting from the purchases and sales of the minority interests are recognised in the statement of changes in equity.

Revenue recognition. Revenue from rendering the electricity transmission services is recognised in the period when the services are provided. Revenue amounts are presented exclusive of value added tax.

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

Revenue from sales of electricity is recognised on the delivery of electricity, exclusive of value added tax.

Note 4. Principal subsidiaries

All subsidiaries are incorporated and operate in the Russian Federation. The principal subsidiaries as at 31 December 2006 and 31 December 2007 are presented below grouped by type of activity.

Transmission companies:

Name	Ownership %	Voting %	Name	Ownership %	Voting %
JSC "The Archangelsk Transmission Company" ^[1]	49.00	59.00	JSC "Mosenergo Transmission company"	50.90	50.90
JSC "The Astrakhan Trunk Grids"	48.66	48.66	JSC "The Nizhny Novgorod Transmission Company"	49.00	49.00
JSC "The Belgorod Transmission Company" ^[1]	49.00	49.00	JSC "The Omsk Transmission Company"	49.00	60.39
JSC "The Bryansk Transmission Company"	49.00	65.22	JSC "The Orenburg Electricity Trunk Grids"	100.00	100.00
JSC "The Buryatiya Trunk Grids"	46.80	46.80	JSC "The Oryol Transmission Company"	49.00	60.35
JSC "The Chelyabinsk Electricity Trunk Grids"	49.00	58.06	JSC "The Penza Transmission Company"	49.00	49.00
JSC "The Chita Trunk Grids"	49.00	62.16	JSC "The Perm Transmission Company"	49.00	64.36
JSC "The Chuvashian Trunk Grids"	100.00	100.00	JSC "Petersburg Trunk Grids"	49.00	57.40
JSC "The Daghestani Trunk Grids"	51.00	51.00	JSC "Rostovenergo Transmission company"	48.43	48.43
JSC "The Electricity Trunk Grids of Komi Republic"	50.11	50.35	JSC "The Ryazan Trunk Grids"	49.00	49.00
JSC "The Ivanovo Trunk Grids" ^[1]	49.66	56.55	JSC "The Samara Transmission Company"	55.03	55.35
JSC "The Kaluga Transmission company"	52.25	52.25	JSC "The Saratov Transmission Company"	53.13	64.04
JSC "The Karelian Trunk Grids"	100.00	100.00	JSC "The Sverdlovsk Trunk Grids"	49.00	65.33
JSC "The Khakassian Trunk Grid Company"	100.00	100.00	JSC "The Smolensk Electricity Trunk Grids"	48.68	59.26
JSC "The Kirov Electricity Trunk Grids"	48.17	48.17	JSC "The Tambov Transmission Company"	49.01	49.01
JSC "The Kola Trunk Grids"	49.20	65.52	JSC "The Tver Trunk Grids" ^[1]	49.00	65.33

FGC UES Group

Notes to the Combined and Consolidated Financial Statements for the year ended 31 December 2007
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Note 4. Principal subsidiaries (continued)

Name	Ownership %	Voting %	Name	Ownership %	Voting %
JSC "The Kostroma Trunk Grids" ^[1]	49.00	65.33	JSC "The Tomsk Trunk Grids"	52.03	59.88
JSC "The Krasnoyarsk Trunk Grids"	51.75	66.33	JSC "The Tula Transmission Company"	49.00	49.00
JSC "The Kuban Trunk Grids"	49.00	49.00	JSC "The Tyumen Transmission company"	100.00	100.00
JSC "The Kurgan Transmission Company"	49.00	49.00	JSC "The Udmurtian Trunk Grids"	49.00	55.39
JSC "The Kursk Trunk Grids" ^[1]	49.00	59.47	JSC "The Vladimir Trunk Grids"	49.00	49.00
JSC "Kuzbassenergo Electricity Trunk Grids"	49.00	49.00	JSC "The Volgograd Trunk Grids"	48.98	61.33
JSC "The Lipetsk Trunk Grids"	49.02	49.02	JSC "The Vologda Trunk Grids"	49.00	49.00
JSC "The Mari Trunk Grids"	64.44	70.07	JSC "The Voronezh Transmission Company"	49.01	49.00
JSC "The Mordovian Transmission Company"	53.14	53.14	JSC "The Yaroslavl Trunk Grids"	47.36	47.36

Other companies:

Name	Ownership %	Voting %	Activity
JSC "Power Industry Research and Development Centre"	100.00	100.00	Research in the sphere of electric power, engineering services, innovative activities, equipment tests and certification, designing electricity grids
JSC "The Moscow Department of Power Communications"	99.99	99.99	Communication services
JSC "Energostroisnabkomplekt"	99.99	99.99	Supply of materials and equipment
JSC "Nurenergo"	77.00	77.00	Distribution and sale of electricity and heat in the Republic of Chechnya

Transmission companies. The shares of the transmission companies (TCs) were received by FGC UES in 2006 and 2007 as payment for additional issues of ordinary shares of FGC UES. These Financial statements present these transactions as transactions under common control (Note 2).

^[1] According to TCs charter documents, when no dividends are paid in relation to preference shares, such shares obtain voting rights for the subsequent year. The voting percentage disclosed in respect of 2007 account for such situations, and may, thus, differ from the voting shares percentage disclosed in 2006.

JSC "Power Industry Research and Development Centre". JSC "Power Industry Research and Development Centre" is a research and development project institution in the sphere of electric power. The shares of JSC "Power Industry Research and Development Centre" were received by FGC UES in September 2007 as the payment for an additional issue of ordinary shares of FGC UES. These financial statements present this transaction as a transaction under common control (Note 2).

JSC "The Moscow Department of Power Communications". JSC "The Moscow Department of Power Communications" is the industry operator of the corporate communication and data transmission system.

JSC "Energostroisnabkomplekt". The shares of JSC "Energostroisnabkomplekt" were purchased from RAO UES in 2007 for consideration of RR 206 million paid in cash. JSC "Energostroisnabkomplekt" organises the supply of goods and services for companies operating in the industry. These financial statements present this transaction as a transaction under common control (Note 2).

JSC "Nurenergo". JSC "Nurenergo" performs electricity and heat distribution and sale activity in the Republic of Chechnya. Due to the difficult operating environment in the Republic of Chechnya, JSC "Nurenergo" has negative net assets after accounting for impairment (Note 6); no minority interest in the negative net asset position of JSC "Nurenergo" is recognised.

FGC UES Group

Notes to the Combined and Consolidated Financial Statements for the year ended 31 December 2007
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Note 5. Related parties

Transactions with RAO UES and the RAO UES Group

In the normal course of business the Group entered into transactions with RAO UES and companies of the RAO UES Group.

The Group had the following significant transactions and balances with RAO UES and companies of the RAO UES Group:

	Year ended 31 December 2007	Year ended 31 December 2006
Transmission revenue	58,013	51 653
Other revenues	1,284	315

Other revenue include revenue from electricity network assets repair and maintenance services as well as non-transmission revenue of the Group's entities.

	31 December 2007	31 December 2006
Accounts payable to shareholders (Note 14)	47,405	34,338
Trade payables	9,665	2,402
Trade receivables (Net of allowance for doubtful debtors of nil as at 31 December 2007 and RR 700 million as at 31 December 2006)	2,260	1,528
Other receivables	3,206	978
Loans received	472	448

All trade receivables from RAO UES Group entities for which the allowance for doubtful debtors was accrued as at 31 December 2006, were collected as at 31 December 2007.

The Company also guaranteed obligations of certain RAO UES Group companies (Note 25).

Other, besides RAO UES and its subsidiaries, state-controlled entities. In the normal course of business the Group enters into transactions with other entities under Government control. Bank loans are provided at the prevailing market rates. Taxes are accrued and settled in accordance with the Russian tax legislation.

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

	Year ended 31 December 2007	Year ended 31 December 2006
Sub-lease expenses of FGC UES paid to ITC Centre	4,472	4,647
Operating lease income of TCs received from ITC Centre	4,488	3,220
Repair and maintenance services income	90	47
Operating expenses	48	-
Interest income	807	99
Interest expenses	3	9

In 2006 and 2007 the ITC Centre (85% owned by the Russian Federation and 15% owned by FGC UES) acted as the lessee of the TC's property, plant and equipment and subleased the property of TCs to FGC UES. Repair and maintenance expenses and depreciation of this property, plant and equipment were borne by the Group's companies.

The income received and expenses incurred in 2007 and in 2006 in relation to operating leases of the TCs' property, plant and equipment are presented net in these Financial statements with receivables and payables remaining on the consolidated balance sheet, based on the substance of the arrangement.

	31 December 2007	31 December 2006
Cash and cash equivalents	9,954	1,841
Advances issued	1,894	1,766
Accounts receivable	71	561
Loans issued	43	0
Accounts payable	792	5

Tax balances and charges are disclosed in Notes 15 and 20. Tax transactions are disclosed in the statement of operations.

FGC UES Group

Notes to the Combined and Consolidated Financial Statements for the year ended 31 December 2007
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Note 5. Related parties (continued)

Directors' compensation. Compensation is paid to members of the Management Board for their services in full time management positions. The compensation is made up of a contractual salary, non-cash benefits, and a performance bonus depending on results for the period according to Russian statutory financial statements. Also, additional medical coverage is provided to the members of Management Board and their close family members.

Fees, compensation or allowances to the members of the Board of Directors for their services in that capacity and for attending Board meetings are paid depending on results for the year. Fees, compensation or allowances to the members of the Board of Directors, being government employees, are not paid.

Total remuneration in the form of salary, bonuses and non-cash benefits provided to the members of the Board of Directors and Management Board for the years ended 31 December 2007 and 2006 was as follows:

	2007		2006	
	Expense	Accrued liability	Expense	Accrued liability
Short-term compensation, including salary and bonuses	36	48	45	54
Remuneration for serving on the Board of Directors	4		2	
Post-employment benefits	15	29		
Total	55	77	47	54

Note 6. Property, plant and equipment

	Buildings	Power transmission grids	Substations	Construction in progress	Other	Total
Appraisal value or cost						
Opening balance as at 31 December 2006	10,789	169,503	80,301	57,489	27,286	345,368
Elimination of accumulated depreciation and impairment	(2,446)	(55,449)	(24,907)	(3,103)	(15,278)	(101,183)
Revaluation increase	5,394	23,681	22,612	10,655	557	62,899
Revaluation loss	(454)	(1,526)	(308)	(1,001)	(3,351)	(6,640)
Additions	10	20	1,185	66,041	1,920	69,176
Transfers	1,466	4,280	7,092	(20,353)	7,515	-
Disposals	(13)	(189)	(789)	(82)	(374)	(1,447)
Closing balance as at 31 December 2007	14,746	140,320	85,186	109,646	18,275	368,173
Accumulated depreciation and impairment						
Opening balance as at 31 December 2006	(2,631)	(56,402)	(27,011)	(3,103)	(15,310)	(104,457)
Reversal of impairment provision	184	953	2,105	-	32	3,274
Elimination of accumulated depreciation and impairment	2,446	55,449	24,907	3,103	15,278	101,183
Charge for the period	(364)	(4,935)	(5,801)	-	(1,960)	(13,060)
Impairment loss	-	-	-	(1,320)	(50)	(1,370)
Disposals	4	1	275	-	17	297
Closing balance as at 31 December 2007	(361)	(4,934)	(5,525)	(1,320)	(1,993)	(14,133)
Net book value as at 31 December 2006	8,158	113,101	53,290	54,386	11,976	240,911
Net book value as at 31 December 2007	14,385	135,386	79,661	108,326	16,282	354,040

FGC UES Group

Notes to the Combined and Consolidated Financial Statements for the year ended 31 December 2007
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Note 6. Property, plant and equipment (continued)

	Buildings	Power transmission grids	Substations	Construction in progress	Other	Total
Appraisal value or cost						
Opening balance as at 31 December 2005	9,624	166,601	73,322	39,880	25,447	314,874
Additions	2	1,114	188	28,506	1,523	31,333
Transfers	1,170	1,789	7,245	(10,712)	508	-
Disposals	(7)	(1)	(454)	(185)	(192)	(839)
Closing balance as at 31 December 2006	10,789	169,503	80,301	57,489	27,286	345,368
Accumulated depreciation and impairment						
Opening balance as at 31 December 2005	(3,595)	(67,742)	(32,043)	(2,598)	(15,222)	(121,200)
Charge for the period	(285)	(4,768)	(2,799)	-	(1,871)	(9,723)
Reversal of impairment loss	1,249	16,108	7,772	-	1,607	26,736
Impairment loss	(1)	-	(1)	(505)	(15)	(522)
Disposals	1	-	60	-	191	252
Closing balance as at 31 December 2006	(2,631)	(56,402)	(27,011)	(3,103)	(15,310)	(104,457)
Net book value as at 31 December 2005	6,029	98,859	41,279	37,281	10,225	193,673
Net book value as at 31 December 2006	8,158	113,101	53,290	54,386	11,976	240,911

Construction in progress is represented by the carrying amount of property, plant and equipment that has not yet been put into operation and advances to construction companies and suppliers of property, plant and equipment. Such advances amounted to RR 15,357 million as at 31 December 2007 (RR 6,916 million as at 31 December 2006).

Depreciation is charged once an asset is available for service.

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

The Group's assets do not include land on which the Group's buildings and facilities are situated. The Group has the option to purchase this land upon application to the state registering body or to formalize the right for rent. According to Russian legislation the expiry date of this option is 1 January 2010 and for the land on which electric power transmission lines are located is 1 January 2013. The Group companies have not filed any application to purchase the land as at 31 December 2007.

Revaluation. The property, plant and equipment have been revalued at 1 January 2007. The revaluation was performed by independent appraisers, who hold a recognised and relevant professional qualification and who have recent experience in valuation of assets of similar location and category. The fair value of property, plant and equipment is measured based on depreciated replacement cost method. The replacement cost for most buildings, power transmission lines, substations and construction in progress is based on their technical capabilities, construction costs and construction cost estimates. The cost to replace the majority of the Group's equipment is measured on the basis of purchase agreements and manufacturers' and selling companies' price-lists. Impairment of property, plant and equipment is assessed using a profitability test with respect to each cash-generating unit - each company of the Group. In doing so the following assumptions have been made:

- The Regulatory Asset Base as the tariff-setting mechanism for electricity transmission will be introduced during 2010-2012;
- The return on investment, provided by the tariff after the Regulatory Asset Base is introduced, will be 9.47%;
- Growth of operating costs will be fully accounted for by the FTS in the course of establishing electricity transmission tariffs;
- The discount rate range used for profitability test varied from 12.43% to 13.55%.

FGC UES Group

Notes to the Combined and Consolidated Financial Statements for the year ended 31 December 2007
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Note 6. Property, plant and equipment (continued)

A 1% change in the expected return on investment or a 1 year delay in introducing the Regulatory Asset Base as the tariff-setting mechanism would impact the carrying amounts of property, plant and equipment by approximately 17% and 11%, respectively.

An increase in the carrying amount resulting from the revaluation of property, plant and equipment has been recognised as a revaluation reserve in equity unless it reverses a previously recognised impairment loss in which case this reversal was recognised in the statement of operations. A decrease in the carrying amount has been recognised as loss on revaluation in the statement of operations.

As a result of revaluation the Group's equity increased by RR 47,803 million, comprising an increase in the carrying value of property, plant and equipment of RR 62,899 million, net of a related deferred tax liability of RR 15,096 million. As a result of recognizing the results of revaluation, RR 3,274 million of previously recognised impairment loss was reversed, and a revaluation loss of RR 6,640 million was recognised in the statement of operations.

For each revalued class of property, plant and equipment stated at revalued amount in these Financial statements, the carrying amount that would have been recognized had the assets been carried under the historical cost basis is as follows:

	Buildings	Power transmission grids	Substations	Construction in progress	Other	Total
Net book value as at 31 December 2007	9,468	113,739	58,762	100,442	17,953	300,364

Before 1 January 2007 the previous revaluation of property, plant and equipment contributed to FGC UES by RAO UES have been performed as at 31 December 2001. The carrying amount of such property, plant and equipment as at 31 December 2006 was RR 173,801 million.

Before 1 January 2007 the property, plant and equipment of the TCs were carried at depreciated replacement cost less impairment and were not subject to revaluation. The carrying amount of such property, plant and equipment as at 31 December 2006 was RR 67,110 million.

Impairment. The impairment loss recognised in 2007 in the amount of RR 1,370 million (2006: RR 522 million) arose in relation to property, plant and equipment of JSC "Nurenergo". As a consequence of the military, political and economic situation in Chechen Republic, the earnings of JSC "Nurenergo" from sales of electricity purchased on wholesale electricity market do not exceed current operating expenses. A 100% impairment loss was recognised in respect of the balance for construction in progress and property, plant and equipment.

Cost and accumulated depreciation of TCs' assets including the impairment provision were recognised by the Group in 2006 at the predecessor values and were revalued at 1 January 2007. The impairment provision included in accumulated depreciation balance as at 31 December 2007 and as at 31 December 2006 is RR 1,370 million and RR 16,932 million, respectively.

Management concluded that as at 31 December 2006 there were indications for reversing the previously recognised impairment losses based on significant changes with a favourable effect on the Group that have occurred or are expected to occur in the near future in the market and economic environment in which the Group operates. Such changes include:

- upward revisions, based on recent trends, in the expected growth of demand for electricity in the majority of the regions of Russia, which supports growth of demand for electricity transmission services;
- expected changes in tariff regulation from the FTS, which assume that the current cost-plus criteria for setting transmission tariff levels will be replaced by the Regulatory Asset Base system, which offers the Group a guaranteed return on its investment base.

Consequently, the Group recorded a reversal of the previously recognised impairment loss in the amount of RR 3,274 million in 2007 (2006: RR 26,736 million). A respective gain together with a corresponding deferred tax expense of RR 786 million (2006: RR 6,417 million), were recognised in the statement of operations for the year ended 31 December 2007 and 31 December 2006, respectively.

FGC UES Group

Notes to the Combined and Consolidated Financial Statements for the year ended 31 December 2007
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Note 6. Property, plant and equipment (continued)

Operating leases. The Group leases a number of land areas owned by the local government under operating lease. The expected lease payments due are determined based on the lease agreements and payable as follows:

	31 December 2007	31 December 2006
Under one year	182	133
Between two and five years	678	454
Over five years	5,510	1,672
Total	6,370	2,259

The above lease agreements are usually signed for period of 1 to 49 years and may be extended for a longer period. The lease payments are subject to review on a regular basis to reflect market rent prices. As at 31 December 2007 the carrying value of property, plant and equipment leased out under operating lease is RR 759 million (31 December 2006: RR 1,913 million).

Note 7. Intangible assets

	Corporate system of managing geographically dispersed resources	Corporate information management system (SAP-R3)	Other software	Total
As at 1 January 2006				
Cost	572	-	553	1,125
Accumulated amortisation	-	-	(32)	(32)
Net book value	572	-	521	1,093
Year ended 31 December 2006				
Opening net book amount	572	-	521	1,093
Additions	311	695	584	1,590
Disposals	-	-	(18)	(18)
Amortisation charge	(20)	(13)	(163)	(196)
Closing net book value	863	682	924	2,469
As at 31 December 2006				
Cost	883	695	1,119	2,697
Accumulated amortisation	(20)	(13)	(195)	(228)
Net book value	863	682	924	2,469
Year ended 31 December 2007				
Opening net book amount	863	682	924	2,469
Additions	605	2,043	937	3,585
Disposals	-	-	(635)	(635)
Amortisation charge	(173)	(307)	(68)	(548)
Closing net book value	1,295	2,418	1,158	4,871
As at 31 December 2007				
Cost	1,488	2,738	1,421	5,647
Accumulated amortisation	(193)	(320)	(263)	(776)
Net book value	1,295	2,418	1,158	4,871

The Corporate system of managing geographically dispersed resources is a software system for gathering, processing and storing information on conditions in the transmission network, which is required for effective maintenance of UNEN. The Corporate system of managing geographically dispersed resources is amortised during 5 years starting from December 2006.

Corporate information management system (SAP-R3) consists of several modules (parts) and related licenses. As at 31 December 2007 only certain modules (parts) were placed in operation and are subject to amortisation. These modules are amortised during 5 years, on a straight-line basis. The related licences are amortised during 10 years.

Other software includes internally generated capitalised software development costs that meet the definition of an intangible asset.

FGC UES Group

Notes to the Combined and Consolidated Financial Statements for the year ended 31 December 2007
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Note 8. Investments in associated companies

The movements in the carrying values of investments in associates are as follows:

Carrying value at 1 January 2007	-
Fair value of net assets of associates acquired	522
Goodwill arising on acquisition of associates	241
Share of profit after tax	1
Impairment	(241)
Translation difference	(14)
Carrying value at 31 December 2007	509

Acquisition of JSC "UES "GruzRosEnergó"

In September 2007 the Group received a 50% interest in the share capital of JSC "UES "GruzRosEnergó" from RAO UES as a consideration for an additional issue of ordinary shares of FGC UES (Note 14) in the amount of RR 763 million. JSC "UES "GruzRosEnergó" was incorporated in 1996 under the Georgian law by its two founders, RAO UES and the state of Georgia, each having 50% of the share capital. The major activities of JSC "UES "GruzRosEnergó" are the transmission of electricity within the energy system of Georgia, import of electricity to Georgia, and the electricity transit from Russia to near-abroad countries.

Management of the Group assessed that the Group does not have control, but exercises significant influence over JSC "UES "GruzRosEnergó". Consequently, as at 31 December 2007 the investment in JSC "UES "GruzRosEnergó" has been accounted for as an investment in an associate.

The fair value of assets and liabilities of the investee at the date of acquisition were as follows:

Non-current assets	1,263
Current assets	23
Non-current liabilities	(171)
Current liabilities	(70)
Fair value of net assets acquired	1,045
Fair value of acquired interest in net assets of entity	522
Goodwill arising from the acquisition	241
Total purchase consideration	763

The amount of goodwill arising on acquisition of JSC "UES "GruzRosEnergó" was impaired at 31 December 2007 and the related charge included in operating expenses in the statement of operations.

The following is summarised financial information in respect of JSC "UES "GruzRosEnergó":

	31 December 2007
Ownership/voting	50%
Total assets	1,253
Total liabilities	(234)
Revenue (for 2007 since the date of acquisition)	24
Expenses (for 2007 since the date of acquisition)	(23)
Profit (for 2007 since the date of acquisition)	1

Note 9. Available-for-sale investments

Available-for-sale investments include shares of JSC "Sangtudinskaya GES-1", which is incorporated and operates in Tajikistan. As at 31 December 2007 and 31 December 2006 the Group's interest in JSC "Sangtudinskaya GES-1" is 21.16%. The shares of JSC "Sangtudinskaya GES-1" are not listed, and no reliable financial information about the operations of JSC "Sangtudinskaya GES-1" is available. Management can not reliably estimate the fair value of such investment; consequently the investment in JSC "Sangtudinskaya GES-1" is carried at cost.

Management had assessed the level of influence that the Group has over JSC "Sangtudinskaya GES-1" and determined that this does not amount to significant influence. The controlling shareholder in JSC "Sangtudinskaya GES-1" is the Russian Federation.

FGC UES Group

Notes to the Combined and Consolidated Financial Statements for the year ended 31 December 2007
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Note 9. Available-for-sale investments (continued)

As at 31 December 2007 the investment in JSC "Sangtudinskaya GES-1" was reclassified from non-current to current available-for-sale investment as the Group intends to dispose this investment within 12 months from balance sheet date.

Note 10. Other non-current assets

	31 December 2007	31 December 2006
Long-term loans issued	297	118
Rosbank promissory notes	195	184
Long-term accounts receivable	89	208
Total financial assets	581	510
Other non-current assets	228	85
VAT recoverable	248	2,674
Total	1,057	3,269

During 2005 the Group acquired non-interest bearing promissory notes of Rosbank in the amount of RR 483 million with a maturity in 2015. These promissory notes were initially recognised in the Financial Statements at their fair value at the acquisition date. Their fair value was determined using a 12 percent discount rate and with reference to their maturity. The effect of the unwinding of discounting on these promissory notes was included in finance cost (Note 23).

Note 11. Cash and cash equivalents

	31 December 2007	31 December 2006
Cash at bank and in hand	12,243	6,362
Cash equivalents	3,002	2
Restricted cash	3	1
Total	15,248	6,365

Cash at bank	Rating	Rating agency	31 December 2007	31 December 2006
JSB Gazprombank	Baa2	Moody's	5,043	-
OJSC Alfa-Bank	Ba1	Moody's	2,106	1,008
JSB Sberbank	Baa2	Moody's	2,045	1,794
JSCB Agropromcredit	-	-	1,474	353
OJSC VTB bank	Baa2	Moody's	1,017	-
OJSC Nota bank	-	-	85	-
CJSC Baltic Bank	B2	Moody's	78	-
JSB Russian Agricultural Bank	BBB+	Fitch Ratings	57	17
OJSC Bank Petrocommerce	Baa2	Moody's	-	2,500
Other	-	-	333	686
Total cash at bank			12,238	6,358

Cash equivalents include short-term investments in certificates of deposit

Bank deposits	Interest rate	Rating	Rating agency	31 December 2007	31 December 2006
JSB Sberbank	6.5%	Baa2	Moody's	3,000	2
Other	-	-	-	2	-
Total bank deposits				3,002	2

Although some of the banks have no international credit rating, management believes that they are reliable counterparties with a stable position on the Russian market.

FGC UES Group

Notes to the Combined and Consolidated Financial Statements for the year ended 31 December 2007
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Note 12. Accounts receivable and prepayment

	31 December 2007	31 December 2006
Trade receivables (Net of allowance for doubtful debtors of RR 1,034 million as at 31 December 2007 and RR 1,327 as at 31 December 2006)	3,167	3,337
Other receivables	2,247	-
Total financial assets	5,414	3,337
Advances to suppliers and prepayments (Net of allowance for doubtful debtors of RR 25 million as at 31 December 2007 and nil as at 31 December 2006)	4,291	2,935
VAT recoverable	5,347	1,602
Tax prepayments	5,954	3,417
Other receivables	4,133	1,332
Total	25,139	12,623

Trade and other receivables are not interest-bearing and are largely due in 30 to 90 days. Given the short period of the repayment of the trade and other receivables, the fair value of such receivables approximates their book value.

Tax prepayments will be settled against future tax liabilities.

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

The movement of the provision for doubtful debts is shown below:

Trade receivables allowance for doubtful debts	2007	2006
As at beginning of the period	1,327	396
Provision reversal	(782)	(358)
Provision accrual	489	1,289
As at the end of the period	1,034	1,327

The provision for doubtful debts primarily relates to accounts receivable of JSC "Nurenergo" in respect of electricity supplied to consumers in the Chechen Republic.

As at 31 December 2007 the overdue receivables for which the provision had not been recorded amounted to RR 813 million (at 31 December 2006: RR 106 million). The ageing analysis is shown below:

	At 31 December 2007	At 31 December 2006
Less than 3 months	54	106
3 to 6 months	249	-
6 to 12 months	446	-
1 year to 5 years	64	-
Total	813	106

Note 13. Inventories

	31 December 2007	31 December 2006
Repair materials	1,499	900
Spare parts	540	527
Other inventories	191	109
Total	2,230	1,536

The cost of inventories is shown net of an obsolescence provision for RR 6 million as at 31 December 2007 and 31 December 2006. At 31 December 2007 and 31 December 2006 the Group had no inventories pledged as security under loan and other agreements.

FGC UES Group

Notes to the Combined and Consolidated Financial Statements for the year ended 31 December 2007
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Note 14. Equity

Basis of presentation of movements in equity. The Group was formed by the combination of electricity transmission businesses under common control. Due to the use of the predecessor basis of accounting (Note 3), the majority of the net equity recognised by the Group is based on the historic carrying value of the net assets of the businesses contributed as recorded in the IFRS financial records of the predecessor enterprises, rather than the fair values of those net assets. Similarly, for the purpose of comparability, the equity of the Group has been presented for comparative periods and as at 1 January 2006 as if the current Group structure has existed from 1 January 2006 (Note 4).

Share capital

	Number of shares issued and fully paid		31 December 2007	31 December 2006
	31 December 2007	31 December 2006		
Ordinary shares	361,382,207,920	243,214,483,559	180,691	121,607

At 31 December 2007 authorised share capital comprises 523,214,483,559 ordinary shares with a nominal value of RR 0.5 per share.

In 2006 the Company commenced the process of issuing additional ordinary shares. As at 31 December 2006 the Company had received consideration for 68,675,855,789 shares in the total amount of RR 34,338 million. This consideration was received from RAO UES in the form of shares of 42 TCs which is based on Russian statutory value of RR 29,764 million, grid assets which is based on Russian statutory value of RR 1,529 million and cash of RR 3,045 million. As at 31 December 2006 the issue was not registered by the Federal Financial Market Service and, consequently, the consideration received was classified as a current liability to shareholders as at that date.

In 2007 the Company completed the issue of these additional shares. The total number of shares issued is 118,167,724,361 with a nominal value of RR 0.5 per share, for the total consideration of RR 59,084 million. The additional consideration was received in 2007 in cash of RR 2,266 million from RAO UES and RR 22,480 million from Russian Federation. Following the issue, the Russian Federation represented by the Federal Agency for Federal Property Management (FAFPM) acquired a 12.44 percent interest in FGC UES. The interest of RAO UES in FGC UES decreased from 100 percent to 87.56 percent.

In August 2007 the Group started the process of placing an additional 114,965,254,235 ordinary shares with an offering price of RR 0.59 per share. As at 31 December 2007 consideration from RAO UES was received for 80,347,312,029 ordinary shares in the form of shares of 8 TCs, JSC "Power Industry Research and Development Centre" and JSC "UES "GruzRosEnergO" which is based on Russian statutory value of RR 9,283 million and cash of RR 38,122 million. The issue was completed and registered in April 2008 (Note 28). Therefore, as at 31 December 2007 the consideration received from RAO UES in total amount of RR 47,405 million is classified as a liability to shareholders.

Merger reserve. Based on the application of predecessor accounting (Note 2), the difference between the value of the share capital issued, the IFRS carrying values of the contributed assets and the minority interest has been recorded as a merger reserve within equity. The value of share capital issued in exchange for assets received from RAO UES in 2007 was recorded as a change in the merger reserve in the total amount of RR 8,727 million; the value of share capital issued in exchange for assets received from RAO UES in 2006 was recorded as a change in the merger reserve in the total amount of RR 29,764 million.

The difference of RR 15,121 million between the value of the share capital issued and the IFRS carrying values of the contributed assets and the minority interest at 31 December 2007 has been recorded as a merger reserve within equity.

The results of operations of the subsidiaries for the period from the 1st of January 2006 up to the date of carve-out are recorded in equity as a distribution to RAO UES

Translation reserve. The translation reserve, relating to the exchange differences arising on translation of the net assets of foreign subsidiaries, as at 31 December 2007 was a debit of RR 14 million (31 December 2006: nil) and is included in retained earnings and other reserves.

FGC UES Group

Notes to the Combined and Consolidated Financial Statements for the year ended 31 December 2007
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Note 14. Equity (continued)

Dividends. The annual statutory accounts of the parent company, FGC UES, form the basis for the annual profit distribution and other appropriations. The specific Russian legislation identifies the basis of distribution as the net profit. For the year ended 31 December 2007, the statutory net profit of the parent company, FGC UES, as reported in the published statutory financial statements for the year ended 31 December 2007, was RR 2,296 million (for the year ended 31 December 2006: RR 1,833 million). However, this legislation and other statutory laws and regulations dealing with the distribution rights are open to legal interpretation and, accordingly, management believes at present it would not be appropriate to disclose an amount for the distributable reserves in these Financial statements.

A dividend was declared in June 2007 in respect of the year ended 31 December 2006 of RR 0.0016 per ordinary share for a total amount of RR 690 million (declared in 2006 in respect of the year ended 31 December 2005: RR 0.0015 per ordinary share for a total amount of RR 372 million).

Note 15. Profit tax

Profit tax expense comprises the following:

	For the year ended 31 December 2007	For the year ended 31 December 2006
Current profit tax charge	(1,683)	(1,807)
Deferred profit tax expense	(638)	(8,010)
Total profit tax expense	(2,321)	(9,817)

During 2007 and 2006 the Group was subject to profit tax rate of 24 percent on taxable profit.

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

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

	For the year ended 31 December 2007	For the year ended 31 December 2006
Profit before profit tax	6,101	37,533
Theoretical profit tax charge at statutory tax rate of 24 percent	(1,464)	(9,008)
Tax effect of items which are not deductible or assessable for taxation purposes	(192)	(439)
Non-recognised deferred tax asset	(665)	(370)
Total profit tax charge	(2,321)	(9,817)

The Group has unrecognised potential deferred tax assets in respect of tax losses carried forward of RR 1,918 million (2006: RR 1,253 million) at JSC "Nurengo". The tax losses expire in 10 years from their origination. In particular, these tax losses expire during 2008-2017, including RR 1,035 million during 2016-2017.

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

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Note 15. Profit tax (continued)

Deferred profit tax assets and liabilities for the year ended 31 December 2007:

	31 December 2007	Movements for the year		31 December 2006
		Recognised in the Statement of operations	Recognised in Equity (Note 6)	
Deferred profit tax liabilities	(32,113)	(847)	(15,096)	(16,170)
Property, plant and equipment	(31,921)	(618)	(15,096)	(16,207)
Accounts receivable and prepayments	(192)	(229)	-	37
Deferred profit tax assets	579	209	-	370
Pension obligation	346	(95)	-	441
Other deferred tax assets	233	304	-	(71)
Deferred profit tax liabilities, net	(31,534)	(638)	(15,096)	(15,800)

The Group recognized temporary differences on property, plant and equipment which relate to differences between accounting and tax bases for depreciation rates, fair values and statutory tax base of property, plant and equipment.

As a result of the revaluation of property, plant and equipment made as at 1 January 2007, the Group recognised deferred tax liabilities in equity in the amount of RR 15,096 million (Note 6).

Deferred profit tax assets and liabilities for the year ended 31 December 2006:

	31 December 2006	Movements for the year recognised in the Statement of operations		31 December 2005
Deferred profit tax liabilities	(16,170)		(7,941)	(8,229)
Property, plant and equipment	(16,207)		(8,058)	(8,149)
Accounts receivable and prepayments	37		117	(80)
Deferred profit tax assets	370		(69)	439
Pension obligation	441		67	374
Other	(71)		(136)	65
Deferred profit tax liabilities, net	(15,800)		(8,010)	(7,790)

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Note 16. Non-current debt

	Currency	Effective interest rate	Due	31 December 2007	31 December 2006
Certified interest-bearing non-convertible bearer bonds, Issue 01	RR	8.80%	18.12.2007	-	5,000
Certified interest-bearing non-convertible bearer bonds, Issue 02	RR	8.25%	22.06.2010	7,000	7,000
Certified interest-bearing non-convertible bearer bonds, Issue 03	RR	7.10%	12.12.2008	7,000	7,000
Certified interest-bearing non-convertible bearer bonds, Issue 04	RR	7.30%	06.10.2011	6,000	6,000
Certified interest-bearing non-convertible bearer bonds, Issue 05	RR	7.20%	01.12.2009	5,000	5,000
Loan from European Bank for Reconstruction and Development	RR	MosPrime + 2.15%	12.06.2014	5,000	5,000
Other non-current debt				472	448
Total non-current debt				30,472	35,448
Less: current portion of non-current debt related to restructuring (Note 28)				(18,000)	-
Less: current portion of non-current debt				(7,472)	(5,000)
Less: Loan from European Bank for Reconstruction and Development reclassified to current debt (Note 18)				(5,000)	(5,000)
Non-current debt				-	25,448

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

During 2004-2006 the Group issued certified interest-bearing non-convertible bearer coupon bonds for the total nominal value of RR 30,000 million. The interest was defined at the time of the issue and is fixed for the maturity period. The coupon is payable semi-annually.

Issue 01 bonds in the amount of RR 5,000 million were repaid in 2007.

As at 31 December 2007 the estimated fair value of total non-current debts (including the current portion) was RR 30,747 million (31 December 2006: RR 35,335 million), which is estimated using the market prices for quoted FGC UES bonds as at 31 December 2007.

Note 17. Pension obligation

The Group's system of post-employment benefits includes the employee pension scheme and various post-employment, retirement and jubilee payments. The post-employment and retirement benefit system is a defined benefit program as part of which every participating employee receives benefits calculated in accordance with certain formula or rules. The program's core element is the corporate pension scheme implemented by the Group in cooperation with the Non-State Pension Fund of Electric Power Industry (NPFE).

The Group also pays various long-term post-employment benefits, including lump sum benefits in case of death of employees or former employees receiving pensions, lump sum benefits upon retirement and in connection with jubilees.

Additionally, financial aid in the form of defined benefits is provided to former employees who have state, industry or corporate awards. Such financial aid is provided both to employees entitled and not entitled to non-state pensions.

The tables below provide information about benefit obligations, plan assets and actuarial assumptions as at 31 December 2007 and 31 December 2006.

FGC UES Group

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Note 17. Pension obligation (continued)

The pension costs stated in the combined and consolidated balance sheet of the Group:

	31 December 2007	31 December 2006
Present value of defined benefit obligations	3,749	3,367
Unrecognised actuarial gains/(losses)	(316)	130
Unrecognised past service cost	(917)	(836)
Pension obligations recorded in the balance sheet	2,516	2,661

The pension costs stated in the combined and consolidated statement of operations:

	For the year ended 31 December 2007	For the year ended 31 December 2006
Current service cost	221	223
Interest cost	233	225
Recognised past service cost	114	106
Curtailement gain	(475)	-
Net expense recognised in the statement of operations	93	554

Changes in the present value of the Group's pension benefit obligation are as follows:

	31 December 2007	31 December 2006
Present value of defined benefit obligations at the year beginning	3,367	3,328
Current service cost	221	223
Interest cost	233	225
Actuarial losses/(gains)	513	(233)
Past service cost	414	-
Benefits paid	(238)	(176)
Curtailement gain	(761)	-
Present value of defined benefit obligations as at 31 December	3,749	3,367

Changes in the pension liabilities are as follows:

	31 December 2007	31 December 2006
Pension liabilities at start of the year	2,661	2,283
Net expense recognised in the statement of operations	93	554
Employer contributions	(238)	(176)
Pension liabilities at end of period	2,516	2,661

Principal actuarial assumptions are as follows:

	31 December 2007	31 December 2006
Nominal discount rate	6.75%	6.75%
Nominal pension entitlement increase (prior to benefit commencements)	7.00%	7.00%
Nominal increase in pensions-in-pay (after benefit commencement)	6.00%	5.00%
Mortality	Russian population Mortality table 1998	Russian population Mortality table 1998

The expected contributions under voluntary pension programs in 2008 are expected in the amount of RR 156 million.

FGC UES Group

Notes to the Combined and Consolidated Financial Statements for the year ended 31 December 2007
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Note 17. Pension obligation (continued)

There were changes in actuarial assumptions during the reporting period, thus actuarial loss arose during this period reflected experience adjustments and the effect of change in actuarial assumptions.

	31 December 2007	31 December 2006
Present value of defined benefit obligations	3,749	3,367
Deficit in plan	(3,749)	(3,367)
Losses/(gains) arising from experience adjustments on plan liabilities	376	(233)

Note 18. Current debt and current portion of non-current debt

	Effective interest rate	31 December 2007	31 December 2006
Current portion of non-current debt related to restructuring (Note 28)	7.2-8.25%	18,000	-
Current portion of non-current debt	7.1-8.8%	7,472	5,000
Loan from European Bank for Reconstruction and Development	MosPrime + 2.15%	5,000	5,000
Other current debt	7.2-8.8%	17	255
Total		30,489	10,255

Current debt includes a loan issued by the European Bank for Reconstruction and Development in the amount of RR 5,000 million due in 2014. The loan was received for the purposes of financing the modernization and reconstruction of large high-voltage electricity substations – the Central Substation and the Arzamas Substation. The loan bears variable interest of MosPrime plus 2.15%.

As at 31 December 2007 and as at 31 December 2006 the Group was not in compliance with certain requirements stated in the conditions of the loan agreement with European Bank for Reconstruction and Development. These breaches gave the European Bank for Reconstruction and Development the right to demand immediate repayment of the loan. Consequently, this loan was reclassified to current debt at both the balance sheet dates.

Note 19. Accounts payable and accrued charges

	31 December 2007	31 December 2006
Trade payables	14,140	8,498
Total financial liabilities	14,140	8,498
Accrued liabilities and other creditors	2,864	1,419
Advances received	4,954	1,069
Total	21,958	10,986

Note 20. Taxes payable

	31 December 2007	31 December 2006
Value added tax	191	188
Property tax	112	77
Profit tax	57	92
Employee taxes	56	34
Other taxes	45	35
Total	461	426

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Note 20. Taxes payable

The value added tax payable is recorded inclusive of deferred value added tax in the amount of RR 15 million (31 December 2006: RR 149 million), which had been incurred prior to 31 December 2005 due to the time difference between revenue recognition and cash receipt from customers. Starting from 1 January 2006 value added tax is payable to the tax authorities on delivery of the goods or services to customers (Note 3), while value added tax originated prior to 1 January 2006 is payable to the tax authorities based on cash receipts from customers or appropriate accounts receivable write-off, but no later than 1 January 2008.

Note 21. Revenues

	For the year ended 31 December 2007	For the year ended 31 December 2006
Transmission fee	59,443	52,688
Electricity sales	795	667
Rental income	486	947
Grids repair and maintenance services	503	91
Other revenues	2,619	2,633
Total	63,846	57,026

Other revenues primarily include revenue from non-core activities, such as communication and agent services.

Note 22. Operating expenses

	For the year ended 31 December 2007	For the year ended 31 December 2006
Depreciation of property, plant and equipment	13,060	9,723
Purchased electricity	11,805	10,744
Employee benefit expenses and payroll taxes	9,499	7,815
Repair and maintenance services: <i>including materials for repair</i>	7,667 1,213	6,124 867
Rent	1,591	1,226
Insurance	1,035	832
Loss on disposal of property, plan and equipment	909	321
Security services	718	573
Research and development	656	399
Consulting, legal and auditing services	654	633
Other materials	548	751
Amortisation of intangible assets	548	196
Information system maintenance	520	106
Taxes, other than on income	484	415
Business trip and travel expenses	257	254
Impairment of investment in associate	241	-
Electricity transit via foreign countries	184	167
Property registration expenses	175	16
(Reversal) / accrual of allowance for doubtful debtors	(268)	1,345
Other	1,499	2,391
Total	51,782	44,031

Starting from 2006 FGC UES purchased electricity to compensate electricity losses during transportation. Previously such losses were a direct expense incurred by the UNEN users. As a result of this change the transmission tariffs were adjusted to compensate for this additional expense.

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Notes to the Combined and Consolidated Financial Statements for the year ended 31 December 2007
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Note 22. Operating expenses (continued)

Employee benefit expenses and payroll taxes include expenses on voluntary pension programs and long-term compensation payments.

	For the year ended 31 December 2007	For the year ended 31 December 2006
Wages and salaries	7,863	6,076
Payroll taxes	1,543	1,185
Pension costs - defined benefit plans	93	554
Total	9,499	7,815

Rent expense principally represent short-term operating lease, including rent of office facilities.

Note 23. Finance cost

	For the year ended 31 December 2007	For the year ended 31 December 2006
Interest expense (debt)	2,700	1,960
Interest expense (discount), net	51	25
Total finance cost	2,751	1,985

The discounting of non-interest bearing debt gives rise to a gain. Subsequent to its initial recognition, the discount is amortised over the period of the debt as an expense.

Note 24. Earnings per ordinary share for profit attributable to the shareholders of FGC UES

	For the year ended 31 December 2007	For the year ended 31 December 2006
Weighted average number of ordinary shares (millions of shares)	351,389	317,183
Profit attributable to the shareholders of FGC UES (millions of RR)	5,526	19,911
Weighted average earnings per share – basic and diluted (in RR)	0.02	0.06

The weighted average number of shares was adjusted to reflect the effect of transactions under common control for shares registered after balance sheet date.

The Group has no dilutive potential ordinary shares; therefore, the diluted earnings per share equals the basic earnings per share.

Note 25. Contingencies, commitments and operating risks

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

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

Legal proceedings. The Group entities are a party to certain legal proceedings arising in the ordinary course of business. In the opinion of management, currently there are no existing legal proceedings or claims outstanding or final dispositions which will have a material adverse effect on the financial position of the Group.

Note 25. Contingencies, commitments and operating risks (continued)

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

As at 31 December 2007 management believes that its interpretation of the relevant legislation is appropriate and the Group's tax, currency and customs positions will be sustained, including the uncertainty of deductibility of certain types of costs for taxation purposes. Where management believes it is probable that a position cannot be sustained, an appropriate amount has been accrued for in these Financial Statements. The Group estimates that possible claims in respect of certain open tax positions of Group companies related to deductibility of certain types of costs for taxation purposes could amount to as much as RR 1,599 million if the tax positions would be successfully challenged.

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

Environmental matters. The enforcement of environmental regulation in the Russian Federation is evolving and the enforcement posture of government authorities is continually being reconsidered. Group entities periodically evaluate their obligations under environmental regulations.

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

Operating environment. Whilst there have been improvements in economic trends in the Russian Federation, the country continues to display certain characteristics of an emerging market. These characteristics include, but are not limited to, the existence of a currency that is not freely convertible in most countries outside of the Russian Federation and relatively high inflation. The tax, currency and customs legislation within the Russian Federation is subject to varying interpretations, and changes, which can occur frequently.

The future economic direction of the Russian Federation is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the Government, together with tax, legal, regulatory, and political developments.

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

Capital commitments. Future capital expenditures for which contracts have been signed amount to RR 97,263 million and RR 61,599 million at 31 December 2007 and 31 December 2006, respectively.

Obligations under guarantee contracts. Guarantee contracts are irrevocable assurances that the Group will make payments in the event of the other party's default on its obligations. The Group guarantees the fulfilment of JSC Kubanenergo's obligations under the loan agreement with JSC Gazprombank in the amount of RR 387 million. The date of termination of the security obligation is 20 November 2008.

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Note 26. Financial instruments and financial risks

Financial risk factors. The Group's ordinary financial and business activities expose it to a variety of financial risks, including but not limited to the following: market risk (foreign exchange risk, interest rate risks related to changes in the fair value of the interest rate and the cash flow interest rate, and price risk), credit risk, and liquidity risk. Such risks give rise to the fluctuations of profit, share capital and cash flows from one period to another. The Group's financial management policy aims to minimize or eliminate possible negative consequences of the risks for the financial results of the Group. From the beginning of operations, the Group has not entered into agreements on derivative financial instruments. However, the Group could use derivative financial instruments from time to time for such purposes as part of its risk management strategy.

Financial instruments by categories:

31 December 2007	Loans and accounts receivable	Assets available for sale	Other financial liabilities	Total
Asset balance sheet items				
Investments available for sale	-	3,035	-	3,035
Other non-current assets (Note 10)	581	-	-	581
Accounts receivable (Note 12)	3,167	-	-	3,167
Other receivables	2,247	-	-	2,247
Bank deposits	140	-	-	140
Cash and cash equivalents (Note 11)	15,248	-	-	15,248
Total assets	21,383	3,035	-	24,418
Liability balance sheet items				
Current debt and current portion of non-current debt (Note 18)	-	-	30,489	30,489
Account payable to shareholders of FGC UES	-	-	47,405	47,405
Account payable and accrued charges (Note 19)	-	-	14,140	14,140
Total liabilities	-	-	92,034	92,034
31 December 2006	Loans and accounts receivable	Assets available for sale	Other financial liabilities	Total
Asset balance sheet items				
Investments available for sale	-	3,035	-	3,035
Other non-current assets (Note 10)	510	-	-	510
Accounts receivable (Note 12)	3,337	-	-	3,337
Cash and cash equivalents (Note 11)	6,365	-	-	6,365
Total assets	10,212	3,035	-	13,247
Liability balance sheet items				
Non-current debt	-	-	25,448	25,448
Current debt and current portion of non-current debt (Note 18)	-	-	10,255	10,255
Account payable to shareholders of FGC UES	-	-	34,338	34,338
Account payable and accrued charges (Note 19)	-	-	8,498	8,498
Total liabilities	-	-	78,539	78,539

(a) Market risk

(i) **Foreign exchange risk.** The Group operates within the Russian Federation. The major part of the Group's purchases are denominated in Russian Roubles. Therefore, the Group's exposure to foreign exchange risk is insignificant.

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Note 26. Financial instruments and financial risks (continued)

(ii) *Interest rate risk.* The Group's operating profits and cash flows from operating activity are largely not dependent on the changes in market interest rates. The Group is exposed to interest rate risk in connection with the market value of interest-bearing long-term borrowings. The majority of interest rates on the borrowing are fixed, the exception being the loan issued by the European Bank for Reconstruction and Development to which a variable interest rate applies (Note 18). The Group's interest-bearing assets consist of certificates of deposit amounting to RR 3,142 million placed at fixed rate.

The Group performs sensitivity analysis for interest rate risk. The assumption of deviation was based on the prediction interest rates as at 31 December 2008.

The shift of predictive interest rates is shown in the table below:

Interest rate risk – MosPrime	Interest rate
As at 31 December 2007	6.08%
As at 31 December 2008	10.04%

An analysis of Group's interest rate exposure indicates that the impact on profit and loss of defined interest rate shift is insignificant.

(b) *Credit risk.* As at 31 December 2007 the amount of financial assets, which are exposed to credit risk, is RR 21,383 million (as at 31 December 2006: RR 10,212 million). Although collection of receivables could be influenced by economic factors, management of the Group believes that there is no significant risk of loss to the Group beyond the provision for impairment of receivables already recorded.

The cash has been deposited in the financial institutions with no more than minimal exposure to the default risk at the time of account opening. Although some of the banks and companies have no international credit rating, management believes that they are reliable counterparties with a stable position on the Russian market.

Credit risk is managed at the Group level. In most cases the Group does not calculate their customers' credit status but rates their creditworthiness on the basis of the financial position, prior experience and other factors.

The Group's customers in 2007 principally represent RAO UES Group entities (Note 5). The table below shows the balances of the ten major customers:

	31 December 2007	31 December 2006
Altayenergo	2,646	148
Dagenergo	526	49
ITC Centre	461	732
Mosenergosbyt	274	1
Inter RAO UES	237	873
Far Eastern Distribution Grid Company	195	168
Tyvaenergo	136	19
Corporate Service System	93	-
GEOINKOM	73	-
Moscow combined electrical grid company	69	18
Total	4,710	1,839

The Group receives bank guarantees in relation to advances paid to construction companies and suppliers of property, plant and equipment. These guarantees represent an irrevocable assurance of the bank to make payments to the Group in the event of the default of the construction company or supplier of property, plant and equipment on its obligations. The total amount of guarantees received is RR 8,322 million as at 31 December 2007 (RR 5,739 million as at 31 December 2006).

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Note 26. Financial instruments and financial risks (continued)

(c) *Liquidity risk.* Liquidity risk is managed at the Group level and includes maintaining the appropriate volume of monetary funds, conservative approach to excess liquidity management, and access to financial resources by securing credit facilities and limiting the concentrations of cash in banks. The table below analyses the Group's financial liabilities into relevant maturity groupings based on the remaining period at the balance sheet to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows. Balances due within 12 months equal their carrying balances, as the impact of discounting is not significant. As at 31 December 2007, Group has made certain reclassification of non-current debts to current debts (Note 28).

	Less than 1 year	1 to 2 years	2 to 5 years	Over 5 years	Total
At 31 December 2007					
Current debt	32,875	-	-	-	32,875
Account payable to shareholders of FGC UES	47,405	-	-	-	47,405
Account payable and accrued charges	14,140	-	-	-	14,140
Total as at 31 December 2007	94,420	-	-	-	94,420
At 31 December 2006					
Non-current and current debt	12,945	9,698	15,673	6,755	45,071
Account payable to shareholders of FGC UES	34,338	-	-	-	34,338
Account payable and accrued charges	8,498	-	-	-	8,498
Total as at 31 December 2006	55,781	9,698	15,673	6,755	87,907

(d) *Fair value.* Management believes that the fair value of financial assets and liabilities is not significantly different from their carrying amounts. The carrying value less impairment provision of trade receivables is assumed to approximate their fair value due to the short-term nature of the receivables. The fair value of financial liabilities for disclosure in the financial statements is estimated by discounting future contractual cash flows at the current market interest rate that is available for Group for similar financial instruments.

Note 27. Capital risk management

The Group's capital management objectives are to ensure that its operations be continued at a profit for the shareholders and with benefits for other stakeholders, and to maintain the optimal capital structure with a view to reduce the cost of capital.

In order to maintain or adjust the capital structure, the Group can adjust the dividends paid to the shareholders or their contributions to the authorized capital by issuing new shares, or by selling assets to reduce debts.

The Group monitors capital ratios, including the gearing ratio, calculated on the basis of figures of financial statements prepared under the Russian Accounting Standards.

Note 28. Post-balance sheet events

Dividends. In June 2008 the Annual General Shareholders' Meeting approved a dividend for 2007 in the amount of RR 380 million or RR 0.0008 per each ordinary share.

Completion of the additional share issue. In April 2008 FGC UES completed the issue of an additional 114,965,254,235 ordinary shares with a par value RR 0.5 each for the amount of RR 67,829 million (Note 14). As a result of this issue the Russian Federation, represented by the Federal Agency for Federal Property Management (FAFPM), increased its interest in FGC UES to 16.13 per cent. The interest of RAO UES in FGC UES reduced from 87.56 per cent to 83.87 per cent.

The final stage of reorganisation. As at 1 July 2008 the reorganization of RAO UES was completed. RAO UES ceased to exist as a legal entity. FGC UES is RAO UES legal successor. The plan of consolidation of the transmission complex, which was approved by the Extraordinary Shareholders' Meeting of FGC UES in December 2007, was substantially fulfilled by the merger of RAO UES, State Holding, Minority Holding FGC UES, 54 transmission companies (TCs), 7 interregional transmission companies (ITCs) into FGC UES in July 2008.

Out of the entities listed above, 50 TCs are consolidated in these Financial statements. The financial effect of the merger with the other entities listed above can not be currently assessed.

FGC UES Group

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Note 28. Post-balance sheet events (continued)

As a result of the completion of the FGC UES restructuring in July 2008, 77.66 per cent of FGC UES shares were owned by the Russian Federation represented by the Federal Agency for Federal Property Management (FAFPM), and 22.34 per cent of FGC UES shares were owned by minority shareholders.

As at the signing date of those Financial statements, FGC UES, the legal successor of RAO UES, is involved in a legal case with Sunflake Ltd concerning the potential invalidation of a purchase agreement of registered ordinary uncertified shares of OJSC Nizhny Novgorod Retail Company. If the agreement is invalidated, FGC UES will have to refund JSC Transneft'servis S RR 2.05 billion and JSC Transneft'servis S will have to return to FGC UES 2.4 million shares of OJSC Nizhny Novgorod Retail Company. The management of FGC UES estimates the risk of occurrence of this event as possible.

Reclassification of non-current debts. In connection with the reorganization of FGC UES approved by shareholders in December 2007, the Company notified its creditors of their right to demand the settlement of liabilities. In this circumstance, in accordance with IAS 1 "Presentation of Financial Statements", the related liabilities in the amount of RR 18,000 million should be presented as current liabilities as FGC UES did not have an unconditional right to defer the settlement of the liabilities for at least 12 months after the balance sheet date.

The Company's creditors had the right to make a claim within 30 days from the date of their notification. The claims received from the creditors up to the date of expiry of the notification period amounted to RR 70 million; the remaining amount of FGC UES non-current debt was reclassified back to non-current liabilities on expiry of the notification period.

Shares of FGC UES. Starting from July 2008 the ordinary registered uncertified shares are traded at the exchanges MICEX and RTS. The shares have been included in the quotation list «B» and received the trading code «FEES».