TGC-2 GROUP
INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS AND INDEPENDENT AUDITOR'S REPORT
FOR THE YEAR ENDED 31 DECEMBER 2008

PRICEWATERHOUSECOOPERS

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INDEPENDENT AUDITOR'S REPORT

To the Shareholders and the Board of Directors of Open Joint Stock Company "Territorial Generating Company #2" (OJSC TGC-2):

We have audited the accompanying combined and consolidated financial statements of OJSC "TGC-2" and its subsidiaries (the "Group") which comprise the combined and consolidated balance sheet as at 31 December 2008 and the combined and consolidated income statement, combined and consolidated statement of cash flows 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

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

Auditor's Responsibility

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

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

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

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Opinion

In our opinion, the accompanying combined and consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2008, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

ZAO PricewaterhouseCoopers Audit

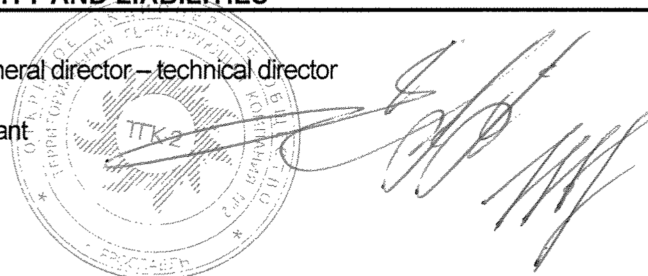
Moscow, Russian Federation
30 July 2009

TGC-2 Group

Combined and Consolidated Balance Sheet as of 31 December 2008

(in thousand of Russian roubles)

	Note	31 December 2008	31 December 2007
ASSETS			
Non-current assets			
Property, plant and equipment	8	24,371,848	23,357,065
Other non-current assets	9	271,900	531,620
Total non-current assets		**24,643,748**	**23,888,685**
Current assets			
Accounts receivable and prepayments	11	4,808,349	3,227,886
Income tax prepayments		46,622	36,721
Inventories	10	2,457,363	2,159,866
Cash and cash equivalents	12	186,413	436,068
Other current assets	13	200,054	-
Total current assets		**7,698,801**	**5,860,541**
TOTAL ASSETS		**32,342,549**	**29,749,226**
EQUITY AND LIABILITIES			
Share capital	14	14,749,024	11,124,969
Treasury shares		(27,427)	-
Share premium		5,294,986	-
Merger reserve	14	(2,750,197)	(2,750,197)
Retained earnings		(717,733)	2,728,730
Other reserves	14, 8	3,482,147	5,858,843
Equity attributable to OJSC TGC-2		**20,030,800**	**16,962,345**
Minority interest		46,704	-
Total equity		**20,077,504**	**16,962,345**
Non-current liabilities			
Non-current borrowings	17	910,000	670,000
Deferred income tax liability	15	1,426,744	3,102,828
Pension liabilities	16	393,658	342,885
Other non-current liabilities		876	4,059
Total long-term liabilities		**2,731,278**	**4,119,772**
Current liabilities			
Current borrowings and current portion of non-current borrowings	17	7,097,098	6,008,900
Accounts payable and accruals	18	2,158,561	2,318,172
Other taxes payable	19	278,108	340,036
Total current liabilities		**9,533,767**	**8,667,109**
Total liabilities		**12,265,045**	**12,786,881**
TOTAL EQUITY AND LIABILITIES		**32,342,559**	**29,749,226**



Deputy of General director – technical director — M. Sh. Shakirov

Chief accountant — Y. V. Ivanova

30 July 2009

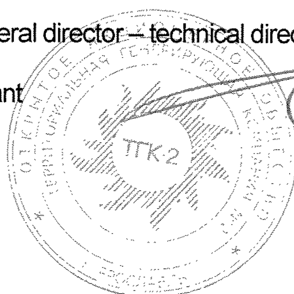
TGC-2 Group

Combined and Consolidated Income Statement for the year ended 31 December 2008
(in thousand of Russian roubles)

	Note	Year ended 31 December 2008	Year ended 31 December 2007
Revenues	20	23,162,841	20,794,791
Operating expenses	21	(27,514,636)	(21,415,331)
Other operating income		92,819	234,147
Impairment charge for property, plant and equipment	8	(982,041)	(1,566,891)
Operating loss		**(5,241,017)**	**(1,953,284)**
Finance expenses	22	(637,311)	(525,630)
Finance income		38,895	-
Loss before income tax		**(5,839,433)**	**(2,478,914)**
Income tax benefit	15	1,102,206	642,548
Loss for the year		**(4,737,227)**	**(1,836,366)**
Loss attributable to:			
Shareholders of OJSC TGC-2	23	(4,783,931)	(1,658,044)
Minority interest		46,704	(178,322)
Weighted average loss per ordinary and preference share – basic and diluted (RR)	23	(0.004)	(0.002)

Deputy of General director – technical director M. Sh. Shakirov

Chief Accountant Y.V. Ivanova



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TGC-2 Group

Combined and Consolidated Statement of Cash Flow for the year ened 31 December 2008

(in thousand of Russian roubles)

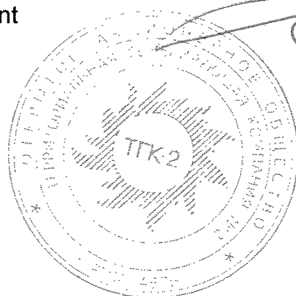
	Note	Year ended 31 December 2008	Year ended 31 December 2007
CASH FLOW FROM OPERATING ACTIVITIES:			
Loss before income tax		**(5,839,433)**	**(2,478,914)**
Adjustments to reconcile loss before tax and net cash from operating activities:			
Depreciation of property, plant and equipment	8, 21	2,538,283	3,184,956
Impairment charge for property, plant and equipment	8	982,041	1,566,891
Charge/(reversal) of impairment provision for accounts receivable	11, 21	965,929	(584,782)
Finance expenses (excluded interest of pension liability)	22	591,424	497,503
Accrual of contingent liabilities provision	25	415,913	-
Loss on disposal of property, plant and equipment		197,191	4,734
Impairment charge for available-for-sale financial assets	9	61,846	-
Increase in pension liabilities	16, 22	34,545	28,127
Write-off of accounts receivable		28,522	17,363
Finance income		(38,895)	-
Excess of Group's interest in fair value of assets and liabilities on subsidiary acquisition	6	(32,268)	-
Losses on disposal of inventory		(30,007)	-
Loss from discounting long-term accounts receivable		-	104,979
Other		23,242	(48,886)
Operating cash flows (used in)/from before working capital changes		**(101,667)**	**2,291,971**
Changes in working capital:			
Decrease/(Increase) in accounts receivable		2,048,350	(414,735)
Increase in inventories		(264,047)	(204,582)
(Decrease)/increase in accounts payable and accruals		(1,023,720)	395,823
Increase in other non-current assets		(611,783)	(339,804)
(Decrease)/increase in other non-current liabilities		(5,084)	106,825
Decrease in taxes payable other than income tax		(83,569)	(55,712)
Income taxes paid in cash		3,149	91,583
Net cash (used in)/from operating activities before changes in working capital		**(38,370)**	**1,871,369**
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of property, plant and equipment	8	(9,571,910)	(1,604,700)
Proceeds from sale of property, plant and equipment		138,884	201
Purchase of subsidiary	6	(149,671)	-
Purchase of promissory notes		(2,513,463)	-
Proceeds from sale of promissory notes		2,318,628	-
Proceeds from sale of subsidiaries		-	34,399
Loans issued		-	(12,090)
Advances issued (financial lease)		-	(3,697)
Interest income		38,895	524
Net cash used in investing activities		**(9,738,637)**	**(1,585,363)**

Combined and Consolidated Statement of Cash Flow for the year ened 31 December 2008
(in thousand of Russian roubles)

	Note	Year ended 31 December 2008	Year ended 31 December 2007
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from borrowings		12,990,716	9,768,707
Issue of bonds		3,087,050	-
Repayment of borrowings		(14,869,733)	(9,163,959)
Interest paid		(542,042)	(562,735)
Lease payments		-	(13,274)
Issuance of shares	14	8,894,986	-
Repurchase of treasury shares	14	(33,625)	-
Net cash generated from financing activities		**9,527,352**	**28,739**
(Decrease/ increase in cash and cash equivalents		**(249,655)**	**314,745**
Cash and cash equivalents at the beginning of the year	12	**436,068**	**121,323**
Cash and cash equivalents at the end of the year	12	**186,413**	**436,068**

Deputy of General director – technical director — M. Sh. Shakirov

Chief Accountant — Y.V. Ivanova



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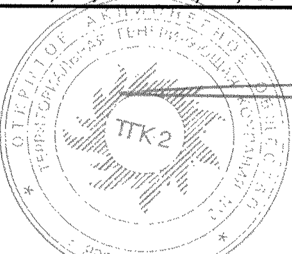
Combined and Consolidated Statement of Changes in Equity for the year ended 31 December 2008

(in thousand of Russian roubles)

	Attributable to shareholders of OJSC TGC-2								
	Share Capital	Share premium	Treasury shares	Merger reserve	Retained earnings	Other reserves	Total	Minority interest	Total equity
As at 1 January 2007	**7,117,127**	**-**	**-**	**(335,453)**	**2,923,874**	**-**	**9,705,548**	**1,771,420**	**11,476,968**
Revaluation of property, plant and equipment (Note 8)	-	-	-	-	-	6,540,866	6,540,866	814,909	7,355,775
Release of revaluation reserve for property, plant and equipment	-	-	-	-	1,463,307	(1,463,307)	-	-	-
Net income recognized directly in equity		-	-	-	1,463,307	5,077,559	6,540,866	814,909	7,355,775
Loss for the year	-	-	-	-	(1,658,044)	-	(1,658,044)	(178,322)	(1,836,366)
Total recognized income for the year 2007		-	-		(194,737)	5,077,559	4,882,822	636,587	5,519,409
Dividends	-	-	-	-	(407)	-	(407)	-	(407)
Issuance of shares (Note 14)	4,007,842	-	-	(2,414,744)	-	814,909	2,408,007	(2,408,007)	-
Provision for buy-out shares	-	-	-	-	-	(33,625)	(33,625)	-	(33,625)
As at 31 December 2007	**11,124,969**	**-**	**-**	**(2,750,197)**	**2,728,730**	**5,858,843**	**16,962,345**	**-**	**16,962,345**
As at 1 January 2008	**11,124,969**	**-**	**-**	**(2,750,197)**	**2,728,730**	**5,858,843**	**16,962,345**	**-**	**16,962,345**
Release of revaluation reserve for property, plant and equipment	-	-	-	-	1,343,666	(1,343,666)	-	-	-
Impairment of property, plant and equipment (Note 8)	-	-	-	-	-	(1,676,289)	(1,676,289)	-	(1,676,289)
Income tax recognized in equity (Note 15)	-	-	-	-	-	402,309	402,309	-	402,309
Effect of change in income tax rate (Note 15)	-	-	-	-	-	207,325	207,325	-	207,325
Net income recognized directly in equity	-	-	-	-	1,343,666	(2,410,321)	(1,066,655)	-	(1,066,655)
Loss for the year	-	-	-	-	(4,783,931)	-	(4,783,931)	46,704	(4,737,227)
Total recognized loss for the year 2008	-	-	-	-	(3,440,265)	(2,410,321)	(5,850,586)	46,704	(5,803,882)
Issuance of shares (Note 14)	3,600,000	5,294,986	-	-	-	-	8,894,986	-	8,894,986
Repurchase of treasury shares (Note 14)	-	-	(33,625)	-	-	33,625	-	-	-
Merger with OJSC TGC-2 Holding (Note 1, 14)	24,055	-	6,198	-	(6,198)	-	24,055	-	24,055
As at 31 December 2008	**14,749,024**	**5,294,986**	**(27,427)**	**(2,750,197)**	**(717,733)**	**3,482,147**	**20,030,800**	**46,704**	**20,077,504**



Deputy of General director – technical director M. Sh. Shakirov

Chief Accountant Y.V. Ivanova

30 July 2009

The accompanying notes are an integral part of these combined and consolidated financial statements

Note 1. The Group and its operations

Open Joint-Stock Company "Territorial Generating Company #2" (hereinafter referred to as "OJSC TGC-2" or "the Company") was established on 19 April 2005 within the framework of Russian electricity sector restructuring in accordance with the Resolution of the Board of Directors of the Russian Open Joint Stock Company for Energy and Electrification Unified Energy System of Russia (hereinafter referred to as "RAO UES of Russia") (Minutes No. 188 of 25 February 2005) and Instruction of the Chairman of the Management Board of RAO UES of Russia (Minutes No. 93 of 18 April 2005).

The Group's principal activity is generation of electricity and heat in the Northern and Central parts of Russia.

The Group manages 16 electric power stations, 13 boiler plants and 5 heating distribution companies. Total installed electric power capacity of the Group is 2,582.5 mW; total heating capacity is 12,473.195 Gcal/h. In addition, the Group owns 56 boiler plants of total installed capacity of 316,86 Gcal/hour.

Legal address: Russia, Yaroslavl, Oktyabrya prospect, 42.

As of 31 December 2008 for the purposes of the combined and consolidated financial statements TGC-2 Group includes OJSC TGC-2 and Arkhangelskaya Generating Company whose assets were merged into OJSC TGC-2 in May 2007 and the subsidiaries of the Company, OJSC Industrial mini-HEPP Bely Ruchey and OJSC Tverskie Kommunalnie Systemy (see Note 6).

OJSC TGC-2 shares are trading on Russian Stock Exchanges – MICEX and RTS.

Changes in the Group's structure. The Extraordinary General Meeting of RAO UES of Russia shareholders held after restructuring, on 26 October 2007 made the decision about spinning-off the holding companies with transfer of the shares of generating companies including OJSC TGC-2 owned by RAO UES of Russia to these holding companies. The holding companies spun-off from RAO UES of Russia were merged into the generating companies in order to convert the shares held by the shareholders of RAO UES of Russia into ordinary shares of the generating companies after restructuring.

OJSC TGC-2 was spun-off from RAO UES of Russia using the following scheme:

- Establishment of OJSC TGC-2 Holding as an independent company on 1 July 2008 through the spin-off from RAO UES of Russia with assets in the form of ordinary shares of OJSC TGC-2 and some assets previously owned by RAO UES of Russia;
- Simultaneously (on 1 July 2008), OJSC TGC-2 Holding merged with OJSC TGC-2 which represents a legal successor. All assets of OJSC TGC-2 Holding (that consist of ordinary shares of OJSC TGC-2 and other assets) were transferred to OJSC TGC-2;
- Due to the merger, OJSC TGC-2 Holding terminated its operations and the shares of OJSC TGC-2 Holding were converted into shares of OJSC TGC-2;
- Each shareholder of RAO UES of Russia:

  a) as of the date of OJSC TGC-2 Holding establishment - received a number of OJSC TGC-2 Holding shares in proportion to the number of RAO UES of Russia shares it owned as of 6 June 2008;

  b) due to the conversion of OJSC TGC-2 Holding shares – they became a shareholder of OJSC TGC-2.

The decision on the restructuring of OJSC TGC-2 in the form of merger of OJSC TGC-2 Holding founded by spinning-off from RAO UES of Russia and the increase in the share capital of OJSC TGC-2 by issuing the additional ordinary registered non-documentary shares was made at the Extraordinary general meeting of the shareholders on 5 December 2007 (Minutes 3 dated 7 December 2007). Method of issue was the conversion of ordinary and preference shares of OJSC TGC-2 Holding into treasury and additional ordinary shares of OJSC TGC-2 under the procedure specified by the decision about restructuring OJSC TGC-2 by merging OJSC TGC-2 Holding into OJSC TGC-2 and the Contract on merging OJSC TGC-2 Holding into OJSC TGC-2. The shares were issued on 01 July 2008. 2,405,498,113 additional ordinary shares totaling RR 24,055 thousand at nominal value were issued.

On 5 December 2007 the Extraordinary Shareholders' Meeting of OJSC TGC-2 shareholders approved of the listing of additional ordinary registered shares in the amount of 2,705,952,526 with the nominal value of RR 0.01

Note 1. The Group and its operations (continued)

each. This decision was made as a result of share conversion due to the merger of OJSC TGC-2 Holding and OJSC TGC-2.

Relations with the State and current legislation. Before 9 June 2008 RAO UES of Russia owned and controlled 49.36% of voting ordinary shares of OJSC TGC-2.

On 9 June 2008 LLC Kores-Invest acquired 45.35% of ordinary shares and became the significant shareholder of the Company. The remaining 54.65 % of ordinary shares is distributed among a large number of shareholders. The ultimate controlling party of LLC Kores Invest is LLC Group Syntez (99% of LLC Kores Invest are controlled by LLC Group Syntez).

As at the reporting date LLC Kores-Invest exercise a significant influence over the Company.

The Group's customer base includes a large number of entities controlled by or related to the state. In addition, the state controls a number of the Group's fuel and other suppliers (see Note 7).

The Government of the Russian Federation directly affects the Group's operations through regulation by the Federal Service on Tariff ("FST"), with respect to its wholesale energy sales, and by the regional services on tariff ("RSTs"), with respect to its heat sales. The operations of all generating facilities are coordinated by JSC System Operator of Unified Energy System ("SO UES"). SO UES is controlled by the Russian Federation.

The Group is affected by Government policy through control of tariffs and other factors. The FST have not always permitted tariff increases in line with the Group's costs and thus some tariffs are insufficient to cover all the costs of generation. Moreover, increases in these tariffs consider costs only on a Russian statutory basis and, accordingly, exclude additional costs recognised under an IFRS basis of accounting. Tariffs for heat are calculated in accordance with a "cost-plus" method, tariffs for electric power and capacity are calculated by an indexation method.

Starting from 1 January 2008, the share of electric power and capacity traded in the wholesale electric power and capacity market at non-regulated prices increased from 10% to 15%. The pace of such increase was set by the Government of the Russian Federation in accordance with socio-economic development forecasts. It is expected that the share of electric power and capacity traded at non-regulated prices will continue to increase and will, by the end of 2011, be the primary market for the distribution and sale of electricity by the Group.

The Russian Government's economic, social and other policies can have a material impact on the Group's operations.

Note 2. Financial position

Operating environment of the Group. The ongoing global financial and economic crisis that emerged out of the severe reduction in global liquidity which commenced in the middle of 2007 has resulted in, among other things, a lower level of capital market funding, lower liquidity levels across the banking sector and wider economy, and, at times, higher interbank lending rates and high volatility in stock and currency markets. The uncertainties in the global financial markets have also led to failures of banks and other corporates, and to bank rescues in the United States of America, Western Europe, Russia and elsewhere. The full extent of the impact of the ongoing Global financial and economic crisis ('the economic crisis") is proving to be difficult to anticipate or completely guard against.

In large part, because of this global economic crisis and despite strong economic growth in recent years, the Russian economy significantly deteriorated during 2008, particularly in the fourth quarter. Since September 2008, there has been a significant decline in the Russian stock market, the Russian Rouble (RR) has depreciated against certain major currencies, domestic interest rates have increased and the commodities industry which is a significant contributor to the Russian economy, has seen prices fall precipitously. Furthermore, the volume of wholesale financing has also been significantly reduced.

To date, the impacts on the Group have ranged from lower demand levels for electricity and heat due to decreasing industrial output across the Russian economy, to increased counter party risk, and to tighter credit markets which could affect the ability of the Group to obtain new borrowings and re-finance its existing borrowings

Note 2. Financial position (continued)

at terms and conditions similar to those applied to earlier transactions. Deteriorating operating conditions for customers of the Group may also have an impact on management's cash flow forecasts and assessment of the impairment of financial and non-financial assets. To the extent that information is available, management has reflected revised estimates of expected future cash flows in their impairment assessments.

Management is unable to reliably estimate the effects on the Group's financial position of any further deterioration in the global or Russian economy. Management believes it is taking all the necessary measures to support the sustainability and development of the Group's business in the current circumstances.

Financial condition of the Group. As of 31 December 2008 the Group's current liabilities exceed its current assets by RR 1,834,964 thousand (as of 31 December 2007 – by RR 2,806,568 thousand).

The outstanding debt amount includes current debts of RR 7,097,098 thousand (see Note 17) which is required to be repaid or refinanced during 2009. Included in the current debt amount is RR 3,087,050 thousand due to issuance of bonds in September 2008 with the annual coupon yield of 10.95%. Bonds have a maturity of three years and holders of the bonds have a right for earlier redemption in one year (in September 2009). Thefore, these bonds were accounted within current debt.

Currently, given the financial crisis, the rate of the coupon yield does not reflect the market loan rates. In order to defer the earlier redemption of bonds or to minimize the number of bonds to be redeemed, the Company considers the following actions:

- Negotiations with bond holders and submitting to them the Company's financial analysis and market overview on OJSC TGC-2 bonds;
- Increase of the coupon rate for the 3d and 4th coupon periods at up to 17-19% p.a.;
- Including of bonds to the Lombard list approved by the Regulations of the Central Bank of the Russian Federation No. 236-P dated 4 August 2003 "On the procedures for granting by the Bank of the Russian Federation credits secured by a pledge (blockage) of securities to credit organizations".

In case it is necessary to buy back part of the bonds, the Company plans to address the bank, who is an organizer of the bond issue, asking for a loan to be used to repay the bonds. In accordance with the terms of the contract on the organization of the bonds issue, the bank is obliged to provide the issuer with a loan support in repaying the bonds under additionally conditions to be agreed in a separate contract. The loan is expected to be repaid out of funds coming from OJSC Arkhangelsk Sales Company, after it receives a grant from the federal budget for the purposes of eliminating cross-subsidy in the electric power industry. The expected amount of the grant to be received in December 2009 is about RR 1,700,000 thousand.

In preparing these financial statements on such a basis, management has considered the macro-economic environment discussed above and the Group's debt position as at 31 December 2008 and believes that through its operations and through its ability to obtain additional financing the Group will be capable of funding its obligations and funding investment and operational requirements for the foreseeable future. In support, management considers the following factors to be significant:

- electricity and heat demand demonstrates a long-term growth trend. The Group does not expect the reduction of production volumes;
- the Group does not plan to dispose any significant part of its assets;
- the Group was included in the list of 300 entities that will receive the state support, if necessary.
- the Group has engaged in a number of measures to reduce costs and match expenditures to available funding, including the deferral of expenditure on certain development projects;
- currently, the Group has unused open lines of credit amounting to approximately RR 6.4 billion in Russian banks, including state-controlled banks; these credit lines will guarantee the financing for the period of one to one and a half years;

Note 2. Financial position (continued)

- the Group is developing the strategy on reduction and optimization of accounts receivable from its major customers buyers.

The Group believes that the efforts and developments discussed above, together with ongoing efforts to secure long-term funding, will be sufficient to ensure the long-term financial stability of the Group and allow for the completion of strategic initiatives to grow the business.

In 2008, the Company did not raise loans in foreign currency; therefore, the sharp drop of the Russian rouble rate did not affect the amount of payments under loan commitments.

Note 3: Basis of preparation

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

Each Group's entity 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.

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

Predecessor accounting. The merger of assets of OJSC Arkhangelskaya Generating Company into and with OJSC TGC-2 was completed in May 2007. Before that, OJSC Arkhangelskaya Generating Company was controlled by RAO UES of Russia holding 48.99% of its ordinary shares.

The Group accounted for the acquisition of businesses under the control of RAO UES of Russia as a business combination amongst entities under common control under an accounting policy using the predecessor values method.

Accordingly, assets and liabilities of the transferred entity were accounted for at the carrying value, as determined by RAO UES of Russia in its IFRS consolidated financial statements. Information in respect of comparative period and opening balance as at 1 January 2007 has been restated as if the business combination took place at the beginning of the earliest period presented.

Going concern. These financial statements have been prepared on a going concern basis, which contemplates the disposal of assets and the settlement of liabilities in the normal course of business for the foreseeable future. The accompanying financial statements do not include any adjustments that might be necessary should the Group be unable to continue as a going concern.

Reclassifications. Certain reclassifications have been made to prior year data to confirm with the current year presentation.

Note 4. Summary of significant accounting policies, critical accounting estimates and assumptions

Principles of consolidation. The combined and consolidated financial statements comprise the financial statements of OJSC TGC-2 and the financial statements of those entities whose operations are controlled by OJSC TGC-2. Control is presumed to exist when the Company owns, directly or indirectly through subsidiaries, more than one half of the voting shares.

a) Subsidiaries

Financial statements of subsidiaries are included in the consolidated financial statements from the date control is established and excluded from the date that control ceases. Any minority interest in the Group's subsidiaries is disclosed as part of equity.

Note 4. Summary of significant accounting policies, critical accounting estimates and assumptions (continued)

b) Transactions eliminated on consolidation

All intercompany balances, transactions and any unrealized gains arising from intercompany transactions are eliminated when preparing the combined and consolidated financial statements.

c) Minority interest transactions

Minority interest transactions are recognized as transactions with owners. When a minority interest is purchased, any difference between the purchase price and the respective portion of balance sheet value of acquired interest in net assets of the subsidiary is recorded in capital.

Transfer of subsidiaries between entities under common control. Contributions to the share capital in the form of interests in subsidiaries from the entities under common control are accounted for using the predecessor values method. Under the predecessor values method of accounting, business combinations are recorded in the financial statements as if the business combination took place as of the beginning of the earliest period presented. The difference between the balance sheet value of net assets and the nominal value of the share capital and other contributions made is recorded as a movement in equity in these combined and consolidated financial statements.

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

Treasury shares. If the Company buys out its treasury shares, the compensation paid, including any additional expenses (minus income tax) is deducted from equity attributable to the company's shareholders until the shares are cancelled, re-issued or eliminated. If in the future such shares are sold or re-issued, the compensation received minus all direct additional costs and the related effect on the income tax are included within equity attributable to the Company's shareholders.

Property, plant and equipment. Starting from 1 January 2007 the Group changed its accounting policy for property, plant and equipment which are now stated at revalued amount less any subsequent accumulated depreciation and subsequent accumulated impairment losses. The revaluation model is applied in relation to all classes of PPE except for the following classes of fixed assets: communications; motor vehicles; computer; instruments, tools; measuring equipment; other machinery. Those classes of PPE are measured at costs less accumulated depreciation and accumulated impairment.

At each reporting date management assesses whether there is any indication of impairment of property, plant and equipment. If any such indication exists, management estimates the recoverable amount, which is determined as the higher of an asset's fair value less costs to sell and its value in use. The carrying amount is reduced to the recoverable amount and the impairment loss is recognised in the income statement to the extent it exceeds the previous revaluation surplus in equity. 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.

Property, plant and equipment are subject to revaluation on a regular basis. 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 are credited to revaluation reserve in equity. Decreases that offset previous increases of the same asset are charged against revaluation reserve directly in equity; all other decreases are charged to the consolidated income statement. Revaluation surpluses realised through the depreciation or disposal of revalued assets are transferred to retained earnings and will not be available for offsetting against future revaluation losses.

When an item of property, plant and equipment was revalued, any accumulated depreciation at the date of the revaluation was eliminated against the gross carrying amount of the asset and the net amount was restated to the revalued amount of the asset.

Further acquisitions of property, plant and equipment between revaluations are recognized at their actual cost.

Note 4. Summary of significant accounting policies, critical accounting estimates and assumptions (continued)

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

Gain or loss from sale or other retirement of property, plant and equipment is determined as the difference between the sales proceeds and book value and is recognized in the income statement.

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 of property, plant and equipment are subject to annual assessment by management and if expectations differ from previous estimates, the changes of useful lives are accounted for as a change in an accounting estimate prospectively. Assessment of the useful lives as at 1 January 2008 was done based on technical condition and plans for future use of the of property, plant and equipment.

The revised useful lives, in years, of revalued assets by type of facility were as follows:

Type of facility	Revised as of 1 January 2008	
	Total useful life	Remaining useful life
Production buildings	5-150	1-147
Hydrotechnical constructions	33-101	1-91
Equipment and plant	2-93	1-39
Substations and power equipment	3-91	1-38
Electric power transmission lines and facilities	16-80	1-27
Heating networks	3-81	1-28
Other	1-107	1-81

Type of facility	Revised as of 1 January 2007	
	Total useful life	Remaining useful life
Production buildings	1-82	2-59
Hydrotechnical constructions	1-101	2-92
Equipment and plant	1-77	1-40
Substations and power equipment	1-69	2-39
Electric power transmission lines and facilities	1-53	2-30
Heating networks	1-73	2-29
Other	1-84	1-59

Subsequent to 1 January 2008, the applied depreciation rates are based on the estimated remaining useful lives as of the valuation date. Had the estimated remaining useful lives not changed since 1 January 2008, the depreciation for the year 2008 would have been higher for RR 1,679,885 thousand. The assessment of the effect of the changes in the useful lives for future periods was not assessed as the Group's management believes that such assessment is not feasible.

Operating lease. If the Group is a lessee under a lease contract according to which the Group is not assigned all risks and benefits related to the title, then payments under the operating lease contracts are recorded in the income statement on a straight-line basis over the lease term.

The lease payments under operating lease contracts (less any allowances provided by the lessor) are recognized in the income statement on a straight-line basis over the lease term.

Financial lease. If the Group is a lessee under a lease contract according to which all risks and benefits related to the title are transferred to the Group, leased assets are capitalized within property, plant and equipment as of the lease relationship conception date at the lower of the fair value of leased assets and the current value of minimum lease payments. All lease payments are allocated between the principal amount and finance charges to ensure a fixed financial lease debt service ratio. Corresponding lease liabilities (less deferred financial charges) are included in debt. Interest costs are recorded in the income statement over the whole lease term using the effective interest rate method. Assets acquired under financial lease are depreciated over their useful life or over the term of the lease contract (if it is shorter) when the Group's management is uncertain whether it will receive the title to the leased assets upon expiration of the lease contract.

Note 4. Summary of significant accounting policies, critical accounting estimates and assumptions (continued)

Cash and cash equivalents. Cash comprises cash in hand and cash deposited on demand at banks. Cash equivalents comprise short-term, highly liquid financial 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.

Inventories. Inventories are valued at the lower of the acquisition cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less selling expenses and completion costs. Cost of inventory is determined on the weighted average basis. For potential losses from obsolescent and slow moving inventories the Company established a provision based on their expected use and future selling prices.

Value-Added Tax. Output VAT is payable to the state budget on the earlier of two dates: (a) when the underlying receivable is recovered or (b) when the title to the goods is transferred to the buyer. Input VAT is recoverable by way of a set-off against the output VAT when the goods are purchased and the invoice is received. Tax authorities allow payment of VAT on a net basis. VAT related to purchase and sale is disclosed separately as a current asset or a short-term liability. Where provision has been made for impairment of receivables, an impairment loss is recorded for the gross amount of the debtor, including VAT.

Classification, valuation and recognition of financial assets. The Group classifies its financial assets in the following categories: financial assets available-for-sale, loans and accounts receivable and financial assets designated at fair value through profit or loss.

Loans issued and accounts receivable are non-quoted non-operational financial assets with fixed or determinable payments provided the Group has no intention of selling them in the short-term.

Financial assets available-for-sale are carried at fair value. Dividends on financial assets available-for-sale are recognized in the income statement when the Group's right to receive them has accrued. Any other changes in the fair value are recorded in equity until the investments are reclassified or impaired. The aggregate profit or loss on disposal is transferred at the date of disposal from equity to the income statement.

Impairment losses on investments held for sale are recognized in Income statement when they occur as a result of an event or a number of events in the period subsequent to the initial recognition of these investments. Significant or lengthy deviation of the fair value of the equity securities from their carrying amount results in the recording of an impairment. Accrued impairment loss determined as the difference between the acquisition cost and the current fair value minus losses previously recorded is transferred from equity and recognized in the income statement. Impairment loss on equity financial instruments is not reversed through profit or loss.

Financial assets designated at fair value through profit or loss represent financial assets held for trading. The Group classifies financial assets within this category (mainly promissory notes), if they were mainly acquired for sale in the short-term period.

Assets of this category are classified as current assets.

Derecognition of financial assets. The Group derecognizes a financial asset when (i) it is paid off or the right to receive cash under this asset has expired for some reason, or (ii) the Group transferred almost all risks and rewards related to the title for this asset, or (iii) the Group neither transferred nor retained almost all risks and rewards related to the title for this asset but lost control over such asset. Control is retained when the counterparty has no practical ability to sell the asset in the aggregate to a third party without the requirement of imposing additional restrictions on its sale.

Accounts receivable and prepayments. Accounts receivable are recorded inclusive of VAT. Trade and other receivables are adjusted for an allowance made for impairment of these receivables. Such an allowance for doubtful debt is established if there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables. The provision represents the difference between the carrying amount and the recoverable amount which is equal to the present value of the expected cash flows discounted at the effective interest rate.

Note 4. Summary of significant accounting policies, critical accounting estimates and assumptions (continued)

Any provision is recognized in the income statement. The primary factors considered by the Group when accounts receivable are impaired are the period over which the accounts receivable are past due and the ability of realizing related security and guarantees, if any. Other criteria also used to determine objective evidence of the impairment are as follows:

- any portion of accounts receivable is past due and the late payment can not be classified as a delay caused by the settlement system;

- the counterparty faces significant financial difficulty which is supported by the financial information received by the Group;

- the counterparty is recognized bankrupt or undergoes financial restructuring;

- existence of unfavorable changes in the counterparty's payment status due to changes in the national and economic situation affecting the counterparty;

- the value of the security received, if any, is much lower as a result of deteriorating market conditions.

Classification of financial liabilities. The Group classifies its financial liabilities as other financial liabilities recorded at amortized cost.

Accounts payable and accrued liabilities. Accounts payable are recorded inclusive of VAT. Trade accounts payable are initially recognized at fair value and subsequently carried at amortized cost calculated using the effective interest rate method.

Income tax. The income tax charge for the period includes current income tax and deferred income tax. The current income tax charge is based on the taxable income for the year. The taxable income is different from the net income recorded in the income statement as it does not include a portion of profit (loss) subject to taxation or elimination in other periods. Current income tax is the amount payable to or recoverable from tax authorities with respect to profit or loss of the current or prior periods. Income tax is disclosed in the consolidated financial statements in accordance with the Russian legislation as of the reporting date indicated on the balance sheet.

The Group records provisions for tax claims and related fines and penalties if the Group has a current tax liability and its amount can be reliably measured. Provision for tax claims is recorded as of the date when they become payable in accordance with the law. Provisions are maintained and accrued, if necessary, for the period over which the respective tax amounts can be reviewed by tax and customs authorities, namely, for 3 years from the filing of tax returns. When such period expires, the provisions are released and disclosed as contingent liability until the expiry of the term established for keeping accounting documentation available, i.e. 2 years (5 years in total).

Liabilities for tax, related fines and penalties are calculated on the basis of the management's estimate of rates set out by relevant laws effective as of the reporting date. Management reviews tax issues as of each reporting date. Income tax liabilities are accrued by the management in instances which can be challenged by tax authorities and result in additional assessment of taxes. The amount of the liability is determined on the basis of legislative acts enacted or significantly enacted as of the reporting date as well as on the basis of precedent legal and other resolutions on similar issues. Liabilities for tax, related fines and penalties, other than income tax, are recorded on the basis of expenses required to cover these liabilities as of the reporting date and accepted by management.

Deferred income tax. Deferred income tax is recognized using the balance sheet liability method and accrued with respect to tax losses carry forward and temporary differences between the value of assets and liabilities for tax and accounting purposes. According to the principle of deferred tax non-recognition upon the initial recognition of transactions, deferred taxes are not recognized for temporary differences that occur on the initial recognition of assets or liabilities in a transaction that is not a business combination if the initial recognition of the transaction affects neither accounting nor taxable profit. Deferred tax balances are measured at the tax rates that are

Note 4. Summary of significant accounting policies, critical accounting estimates and assumptions (continued)

accepted or effective as of the reporting date and expected to be applied to the temporary differences when they reverse or tax losses when they are utilized. Deferred tax assets and liabilities are recorded on a net basis exclusively in the individual financial statements of the Group companies. Deferred tax assets for deductible temporary differences and tax losses carry forward are recognized to the extent that future taxable profits will be available against which temporary differences and tax losses can be utilized.

Borrowings. Borrowings are initially recognized at fair value. Fair value is determined using market rates of interest for similar instruments, if significantly different from the interest rates under a loan received. In subsequent periods, the borrowings are stated at amortized cost using the effective interest rate method; any difference between the initially recognized amount and the redemption amount is recorded in the income statement as an interest expense over the period of the liability on the redemption of the borrowings. All borrowing costs, including costs on borrowings raised for the construction of property, plant and equipment are recognized as incurred within expenses in the income statement.

Minority interest. Minority interest represents the minority shareholders' proportionate share of the equity and results of operations of the Company's subsidiaries. It is calculated based upon the minority interests' ownership percentage of these subsidiaries. On acquisition of a minority interest, the difference between the carrying amount of the minority interest and the amount paid on acquisition is charged to losses directly within owner's equity.

Provisions. Provisions are recognized if the Group has a present legal or constructive obligation as a result of past events, and it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

Pension benefits and other social obligations. In the normal course of business the Company contributes to the Russian Federation State Pension Plan on behalf of its employees. Mandatory contributions to the pension scheme are expensed as incurred and included in the line "Payroll and payroll taxes" in the Income statement.

The Group entities implement defined benefit pension plans that covers most of its employees. The defined benefit plans represent pension benefits receivable by employees upon their retirement; the amount of the benefit depends on a number or factors such as age, the period of service and salary. The obligation recorded in the balance sheet as of the reporting date in connection with the defined benefit plan is the discounted value of the obligation to pay defined benefits less the fair value of any plan assets, including the adjustments on non-recognized actuarial gains and losses. The defined benefit obligation is calculated using the projected unit credit method. The present value of defined benefits obligations is determined through the discounting of the estimated future cash outflow using interest rates on government bonds which are denominated in the same currency as that of the pension benefits and have a maturity term approximating the terms of settlement for the related pension obligations.

Actuarial gains and losses resulting from updated actuarial estimates and exceeding 10% of the pension plan assets or 10% of the recognized pension obligations are recorded in the income statement over the expected average term of employee service.

Revenue recognition. The Group's revenues are recognized on the delivery of electricity and heat and the dispatch of non-utility goods and services. Revenue is presented exclusive of value added tax.

Season and climate impact the demand for heat and electricity. Major revenues from heat sales are generated over the period from October to March. Similarly, though not so evidently, major electricity sales fall within the same period. Seasonality of heat and electricity generation influences fuel consumption and energy purchases accordingly.

In addition, repairs and maintenance expenses increase in the period of reduced generation from April to September. Seasonality does not have a significant impact on the recognition of the Group's revenue and expenses.

Earnings per share. Preferred shares are taken into account in the calculation as the related dividends are not permitted to be lower than the dividends on ordinary shares. Earnings per share are determined by dividing the profit attributable to holders of ordinary and preferred shares by the weighted average number of ordinary and preferred shares outstanding over the reporting period, less the average number of the Group's treasury shares.

Note 4. Summary of significant accounting policies, critical accounting estimates and assumptions (continued)

Segment reporting. The Group operates within one geographic and industrial segment – electricity and heat generation in the Russian Federation. Electricity and heat generation activities are similar and exposed to similar risks, thus they are presented as a single operational unit.

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

Impairment provision for accounts receivable. The impairment provision for accounts receivable is based on the Group's assessment of the collectability of specific customer accounts. If there is deterioration in a major customer's creditworthiness or actual defaults are higher than the estimates, the actual results could differ from these estimates.

Accounts receivable recognized as bad debt in the reporting period are written off against the impairment provision for accounts receivable in the amount provided for earlier. If the amount of the above accounts receivable being written-off exceeds the impairment loss recognized in prior reporting periods, the surplus is directly charged to the operating expenses.

***Impairment of property, plant and* equipment.** The book value of the Group's property, plant and equipment is analyzed at each reporting date to identify whether there is any indication of their potential impairment. If such indication exists the recoverable cost of assets is estimated (see Note 8).

The recoverable cost of an asset or cash-generating unit is the higher of an asset's fair value less costs to sell and its value in use. When calculating value in use the expected future cash flows are discounted to their present value by applying the pre-tax discount rate that reflects the current market-value assessment of impact of changes in value of money in course of time and risk specific to this asset. For the purposes of this assessment for impairment the assets are combined to the lowest aggregation of assets that generates cash inflow attributable to the use of the respective assets and the cash inflow mainly is independent of the cash inflow generated by other assets or groups of assets (cash generating unit).

An impairment loss is recognized, only if the book value of an asset or cash-generating unit to which the asset belongs is higher than its recoverable cost; impairment losses are recognized in the Income statement unless they reverse a previously recognised revaluation surplus. Losses from impairment of cash-generating units are proportionally charged against the decrease in book values of assets within the respective cash-generating unit (a group of cash-generating units). At each reporting date the management analyzes the impairment loss recognized in one of prior periods to identify whether there is any indication that the loss should be decreased or derecognized. The amounts charged against impairment losses are reversed, if the assessment factors used to calculate the recoverable cost change. Impairment loss is reversed only at the amount enabling to recover the assets' cost to its book value at which they would be recognized, if the impairment loss were not recognized.

Tax contingencies. Russian tax legislation is subject to varying interpretations. The Group's uncertain tax positions (potential tax gains and losses) are reassessed by management at every balance sheet date. Liabilities are recorded for profit tax positions that are determined by management based on the interpretation of current tax laws. Liabilities for penalties, interest and taxes other than on profit are recognized based on management's best estimates of the expenditure required to settle tax obligations at the balance sheet date (see Note 25).

Useful lives of property, plant and equipment. Useful lives of property, plant and equipment are estimated by the management based on the experience in estimating similar assets. When determining the useful lives of the assets management considers the mode of use, technical conditions and environment in which this asset will be used. Changes in one of the above conditions can have an impact on the established depreciation rates in the future (for more information see accounting policy for Property, Plant and equipment).

Note 4. Summary of significant accounting policies, critical accounting estimates and assumptions (continued)

Accounting for assets and liabilities of pension plan. The assessment of pension plan liabilities is based on the actuarial methods and assumptions. Actual results can differ from estimates and the Group's estimates can be adjusted in future (Note 16).

Note 5. New Standards and Interpretations

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 2007.

Certain new interpretations became effective for the Group from 1 January 2008:

- IFRIC 11, IFRS 2 "Group and Treasury Share Transactions" (effective for annual periods beginning on or after 1 March 2007);
- IFRIC 12, "Service Concession Arrangements" (effective for annual periods beginning on or after 1 January 2008); and
- 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).

These interpretations did not have any significant effect on the Group's consolidated financial statements.

"Reclassification of Financial Assets" Amendments to IAS 39, "Financial Instruments: Recognition and Measurement", and IFRS 7, "Financial Instruments: Disclosures and a subsequent amendment", "Reclassification of Financial Assets: Effective Date and Transition". The amendments allow entities the options (a) to reclassify a financial asset out of the held for trading category if, in rare circumstances, the asset is no longer held for the purpose of selling or repurchasing it in the near term; and (b) to reclassify an available-for-sale asset or an asset held for trading to the loans and receivables category, if the entity has the intention and ability to hold the financial asset for the foreseeable future or until maturity (subject to the asset otherwise meeting the definition of loans and receivables). The amendments may be applied with retrospective effect from 1 July 2008 for any reclassifications made before 1 November 2008; the reclassifications allowed by the amendments may not be applied before 1 July 2008 and retrospective reclassifications are only allowed if made prior to 1 November 2008. Any reclassification of a financial asset made on or after 1 November 2008 takes effect only from the date when the reclassification is made.

The Group has not elected to make any of the optional reclassifications during the period.

The following new standards, amendments to standards and interpretations have been issued and are effective for the financial years beginning after 1 January 2009 and have not been early adopted:

- IFRS 8 "Operating Segments" (effective for annual reporting 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 will apply the new standard from 1 January 2009 and is currently assessing what impact the new IFRS will have on its combined and consolidated financial statements.
- Amendment to IAS 23 "Borrowing Cost" (effective for borrowing costs relating to qualifying assets for which the commencement date for capitalisation is on or after 1 January 2009). The revised IAS 23 was issued in March 2008. 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 consolidated financial statements.
- Amendment to IAS 1 "Presentation of Financial Statements" (revised in September 2007, effective for annual reporting periods beginning on or after 1 January 2009). The main change in IAS 1 is the replacement of the

Note 5. New Standards and Interpretations (continued)

income statement by a statement of comprehensive income which will also include all non-owner changes in equity, such as the revaluation of available-for-sale financial assets. Alternatively, entities will be allowed to present two statements: a separate income statement and a statement of comprehensive income. The revised IAS 1 also introduces a requirement to present a statement of financial position (balance sheet) at the beginning of the earliest comparative period whenever the entity restates comparatives due to reclassifications, changes in accounting policies, or corrections of errors. The Group expects the revised IAS 1 to affect the presentation of its consolidated financial statements starting in 2009.

- Amendment to IAS 32 and IAS 1, "Puttable Financial Instruments and Obligations Arising on Liquidation" (effective for annual periods beginning on or after 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 27, "Consolidated and Separate Financial Statements" (revised January 2008, effective for annual periods beginning on or after 1 July 2009). The revised IAS 27 will require an entity to attribute total comprehensive income to the owners of the parent and to the non-controlling interests (previously "minority interests") even if this results in the non-controlling interests having a deficit balance (the current standard requires the excess losses to be allocated to the owners of the parent in most cases). The revised standard specifies that changes in a parent's ownership interest in a subsidiary that do not result in the loss of control must be accounted for as equity transactions. It also specifies how an entity should measure any gain or loss arising on the loss of control of a subsidiary. At the date when control is lost, any investment retained in the former subsidiary will have to be measured at its fair value. The Group is currently assessing the impact of the amended standard on its consolidated financial statements.
- Amendments to IFRS 2, "Share-based Payment Vesting Conditions and Cancellations" (effective for annual periods beginning on or after 1 January 2009). The amendment deals with two matters: it clarifies that vesting conditions are service conditions and performance conditions only. Other features of a share-based payment are not vesting conditions. It also specifies that all cancellations, whether by the entity or by other parties, should receive the same accounting treatment. The Group does not expect the amendment to affect its consolidated financial statements.
- 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 acquisition method to business combinations. The requirement to measure at fair value every asset and liability at each step fin a step acquisition for the purposes of calculating a portion of goodwill has been removed. Instead, in a business combination achieved in stages, the acquirer will have to remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss. Acquisition related costs will be accounted for separately from the business combination and, therefore, recognized 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 the new standard to any business combination in 2010.
- Amendment to IFRS 1 and IAS 27 "Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate" (revised May 2008; effective for reporting 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.
- 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 to IAS 39 clarifies how the principles that determine whether a hedged risk or portion of cash

Note 5. New Standards and Interpretations (continued)

flows is eligible for designation should be applied in particular situations. The Group is currently assessing the impact of the amendment on its consolidated financial statements.

- IFRIC 13, "Customer Loyalty Programmes" (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. The Group does not 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. IFRIC 15 is not currently relevant to the Group's operations because it does not have any agreements for the construction of real estate.
- 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. The Group is currently assessing the impact of the amended standard on its consolidated financial statements.
- IFRIC 17, "Distribution of Non-Cash Assets to Owners" (effective for annual periods beginning on or after 1 July 2009, with earlier application permitted). The interpretation clarifies when and how distribution of non-cash assets as dividends to the owners should be recognised. An entity should measure a liability to distribute non-cash assets as a dividend to its owners at the fair value of the assets to be distributed. A gain or loss on disposal of the distributed non-cash assets will be recognised in profit or loss when the entity settles the dividend payable. The Group will apply IFRIC 17 if it distributes non-cash assets to owners in the future.
- IFRS 1, "First-time Adoption of International Financial Reporting Standards" (effective for the first IFRS financial statements for a period beginning on or after 1 July 2009). The revised IFRS 1 retains the substance of its previous version but within a changed structure in order to make it easier for the reader to understand and to better accommodate future changes. The Group concluded that the revised standard does not have any effect on its consolidated financial statements.
- The amendments to the IFRSs which are the part of the IASB's annual improvements project published in May 2008 are effective from 1 January 2009. 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

Note 5. New Standards and Interpretations (continued)

accounting. The Group does not expect the amendments to have any material effect on its consolidated financial statements.

- On 16 April 2009 the IASB issued "Improvements to IFRSs", a collection of amendments to 12 standards as part of its program of annual improvements. The latest amendments were included in exposure drafts published in October 2007, August 2008 and January 2009. Most of the amendments are effective for annual periods beginning on or after 1 January 2010. The Group is assessing the impact of those pronouncements on its consolidated financial statements.
- IFRIC 18, "Transfers of Assets from Customers" (effective for annual periods beginning on or after 1 July 2009). The interpretation clarifies the accounting for transfers of assets from customers, namely, the circumstances in which the definition of an asset is met; the recognition of the asset and the measurement of its cost on initial recognition; the identification of the separately identifiable services (one or more services in exchange for the transferred asset); the recognition of revenue, and the accounting for transfers of cash from customers. IFRIC 18 is not expected to have any impact on the Group's consolidated financial statements.
- Improving Disclosures about Financial Instruments - Amendment to IFRS 7, "Financial Instruments: Disclosures" (issued in March 2009; effective for annual periods beginning on or after 1 January 2009). The amendment requires enhanced disclosures about fair value measurements and liquidity risk. The entity will be required to disclose an analysis of financial instruments using a three-level fair value measurement hierarchy. The amendment (a) clarifies that the maturity analysis of liabilities should include issued financial guarantee contracts at the maximum amount of the guarantee in the earliest period in which the guarantee could be called; and (b) requires disclosure of remaining contractual maturities of financial derivatives if the contractual maturities are essential for an understanding of the timing of the cash flows. An entity will further have to disclose a maturity analysis of financial assets it holds for managing liquidity risk, if that information is necessary to enable users of its financial statements to evaluate the nature and extent of liquidity risk. The Group is currently assessing the impact of the amendment on disclosures in its consolidated financial statements.
- Amendments to IFRIC 9 and IAS 39 "Embedded Derivatives" (effective for annual periods ending on or after 30 June 2009). The amendments clarify that on reclassification of a financial asset out of the "at fair value through profit or loss" category, all embedded derivatives have to be assessed and, if necessary, separately accounted for. The Group is currently assessing the impact of the amendment on disclosures in its consolidated financial statements.

On 9 July 2009 IASB issued an International Financial Reporting Standard designed for use by small and medium-sized entities (IFRS for SMEs). IFRS for SMEs simplified many of the principles of full IFRS for recognising and measuring assets, liabilities income and expense, and the number of required disclosures have been simplified and significantly reduced. IFRS for SMEs is not applicable for the Group's operations.

Note 6. Acquisition

In September 2008 the Group acquired 100% of share capital of OJSC Tverskie Kommunalnie Systemy (hereinafter referred to as "TKS") was owned by OJSC Rossiskie Kommunalnie Systemy. Total consideration paid was RR 150,500 thousand. Thus, the Group obtained control over TKS since September 2009.

Note 6. Acquisition (continued)

The fair value and carrying value of assets and liabilities arising from the acquisition are as follows (RR thousand):

	Fair values	Carrying values
Property, plant and equipment	303,293	40,022
Other non-current assets	963	944
Accounts receivable	517,622	857,725
Inventory	19,593	20,531
Other current assets	6,884	10,208
Pension liabilities	(16,486)	-
Other non-current liabilities	(342,826)	(398,052)
Current borrowings	(157,623)	(165,448)
Accounts payable and accruals	(123,169)	(125,471)
Other current liabilities	(25,483)	(25,671)
Net assets acquired	**182,768**	**214,788**
Excess of Group's interest in fair value of assets and liabilities	(32,268)	
Total purchase consideration	**150,500**	
Less: cash and cash equivalents in entity acquired	(829)	
Cash outflow on the acquisition	**149,671**	

The fair value assessment of TKS was performed by an independent appraiser, who hold a recognized and relevant professional qualification and who have recent experience in valuation of assets of similar location and nature. The basis used for the appraisal was depreciated replacement cost.

The final fair value reflects the current conditions of the electricity and heat market and the changes arising from reform of the sector at the date of acquisition. The excess of the Group's interest in fair value of assets and liabilities in the amount RR 32,268 thousand was recognised in the Income statement. This gain was generated as a result of the Group's ability to benefit from synergies available to it because of its position in the electricity and heat markets and the Group's economic and political connections in markets in Tver region.

TKS contributed revenues of RR 172,386 thousand and a net profit of RR 114,242 thousand to the Group for the period from the date of acquisition to 31 December 2008.

Note 7. Related parties

The definition of a "related party" is provided in IAS 24 "Related Party Disclosure". For the purposes of these financial statements parties are considered to be related if one party has the ability to control the other party, is under common control, or can exercise significant influence over the other party in making financial and operational decisions, or the party is a member of the key management personnel of the entity or its parent. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

Related parties include shareholders who have significant influence or control the Group, directors, subsidiary and associated companies as well as entities controlled by the state.

The nature of the related party relationships for those related parties with whom the Group entered into significant transactions for the year ended 31 December 2008 or had significant balances outstanding as of 31 December 2008 are detailed below.

Since June 2008 RAO UES of Russia is not a related party of OJSC TGC-2 due to the sale of the Company (see Note 1).

Balances with RAO UES of Russia were as follows:

	31 December 2008	31 December 2007
Accounts payable and accruals	-	2,431

Note 7. Related parties (continued)

Transactions with RAO UES of Russia were as follows:

	Period from 01 January 2008 up to 08 June 2008	Year ended 31 December 2007
Interest expense	-	17,874

Transactions with RAO UES subsidiaries and associates

Transactions with RAO UES of Russia subsidiaries and associates include:

	Period from 01 January 2008 up to 08 June 2008	Year ended 31 December 2007
Electricity and heat sales	2,958,713	6,565,785
Other income	-	62,882

	Period from 01 January 2008 up to 08 June 2008	Year ended 31 December 2007
Purchase of electricity	57,247	111,780
Purchase of heat energy	-	85,422
Dispatcher services	71,197	122,735
Rental expenses	-	14,205
Other expenses	-	2,033

Balances with RAO UES of Russia subsidiaries and associates at the end of the period were as follows:

	31 December 2008	31 December 2007
Accounts receivable and prepayments (net of provision for impairment of RR 00 thousand as at 31 December 2007)	-	1,134,340
Accounts payable and accruals	-	(15,153)

State controlled entities. In the normal course of business the Group enters into transactions with other state controlled entities. Prices of natural gas, electricity and heat are based on tariffs set by FST and RST. Bank loans are granted at market rates. Taxes are accrued and settled in accordance with the Russian tax legislation.

The Group had the following material transactions with state controlled entities in the period from 1 January 2008 up to 8 June 2008 (the period when OJSC TGC-2 was part of RAO UES of Russia):

	Period from 01 January 2008 up to 08 June 2008	Year ended 31 December 2007
Purchase of fuel	(3,563,750)	(5,102,595)
Sale of electric and heat energy	2,287,920	5,815,610
Interest expense	(140,838)	(372,717)

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

	31 December 2008	31 December 2007
Cash	-	393,425
Short-term accounts receivable and prepayments (net of provision for impairment of RR 654,681 thousand as at 31 December 2007)	-	1,161,017
Borrowings (see Note 17)	-	(6,667,600)
Accounts payable and accruals	-	(62,922)

Tax balances are disclosed in the balance sheet and in notes 11 and 19. Tax settlements are disclosed in the combined and consolidated statement of income and in Note 21.

Note 7. Related parties (continued)

Balances with LLC Kores Invest (significant shareholder) include:

	31 December 2008	31 December 2007
Accounts receivable and prepayments(net of provision for impairment of RR 00 thousand as at 31 December 2008)	557	-

The above accounts receivable relate to compensation of expenses on publication, there were no other related party transactions in the period from 09 June 2008 up to 31 December 2008.

Key management personnel. Key management of the Company includes: Board of Directors and Management Board members.

	Year ended 31 December 2008	Year ended 31 December 2007
Remuneration paid to key management personnel, in the aggregate, including by types of payments:	229,228	85,463
- short-term benefits (salary, bonuses and reward)	133,212	85,463
- termination benefits	96,016	-

Loans provided to members of the Board of Directors and Management Board, top managers were as follows:

	Year ended 31 December 2008	Year ended 31 December 2007
Receivables as of 1 January	5,064	6,779
Granted	-	-
Repaid	(2,345)	(1,715)
Receivables as of 31 December	2,719	5,064

As of 31 December 2008 the Board of Directors had 11 members and the Management Board – 5 members.

Termination benefits. In February 2008 the Group entered into additional agreements to employment contracts with the General Director and Deputies of the General Director. These agreements set out the procedure, terms and conditions of termination benefits payable to top managers of the Group when they are dismissed. The amount of such benefit payable to each individual depends on the cause and date of the termination. Termination benefits paid to the General Director and his deputies upon termination of their labor agreements in October 2008 amounted to RR 96 million.

The Company employees have the right for non-state pensions upon retirement. In 2008 there were no payments with respect to key management personnel, and in 2009 such payments will amounted to RR 51 thousand. The Company makes contributions for its employees into the non-state pension fund.
Total contributions made to the non-state pension fund in 2008 were RR 933 thousand.

Note 8. Property, plant and equipment

	Factory building	Hydrotechnical constructions	Equipment and plant	Electric power substation and power equipment	Power lines and transmission facilities	Heat networks	Constraction in progress	Other	Total
Cost									
Balance as of 1 January 2008	6,790,371	327,489	5,375,606	1,126,959	35,507	5,253,340	2,513,390	5,119,002	26,541,664
Acquisition of subsidiary	-	-	15,354	-	-	280,024	822	7,093	303,293
Additions	261	-	1,101	76	-	-	6,210,682	32,910	6,245,030
Transfers	338,375	5,402	227,251	48,951	3,164	186,084	(1,117,163)	307,936	-
Disposals	(7,319)	-	(1,961)	(17,084)	-	(790)	(281,215)	(49,946)	(358,315)
Balance as of 31 December 2008	7,121,688	332,891	5,617,351	1,158,902	38,671	5,718,658	7,326,516	5,416,995	32,731,672
Accumulated depreciation (including impairment)									
Balance as of 1 January 2008	(700,219)	(5,971)	(535,559)	(156,113)	(8,653)	(907,942)	-	(870,142)	(3,184,599)
Impairment charge	(681,480)	(30,988)	(539,690)	(126,104)	(3,828)	(413,727)	(247,255)	(615,258)	(2,658,330)
Charge for the period	(389,748)	(5,496)	(426,205)	(133,162)	(4,625)	(980,102)	-	(598,945)	(2,538,283)
Disposals	271	-	164	2,088	-	-	-	18,865	21,388
Balance as of 31 December 2008	(1,771,176)	(42,455)	(1,501,290)	(413,291)	(17,106)	(2,301,771)	(247,255)	(2,065,480)	(8,359,824)
Net book value as of 1 January 2008	6,090,152	321,518	4,840,047	970,846	26,854	4,345,398	2,513,390	4,248,860	23,357,065
Net book value as of 31 December 2008	5,350,512	290,436	4,116,061	745,611	21,565	3,416,887	7,079,261	3,351,515	24,371,848

Note 8. Property, plant and equipment (continued)

	Factory building	Hydrotechnical constructions	Equipment and plant	Electric power substation and power equipment	Power lines and transmission facilities	Heat networks	Constraction in progress	Other	Total
Cost									
Balance as of 1 January 2007	7,825,422	286,925	7,090,161	3,071,826	48,329	7,011,921	2,100,722	4,939,227	32,374,533
Elimination of accumulated depreciation	(3,169,332)	(221,092)	(2,716,670)	(1,401,509)	(25,397)	(4,721,134)	-	(3,423,537)	(15,678,671)
Revaluation	1,890,268	230,449	548,530	25,030	10,459	2,841,842	753,379	3,378,694	9,678,651
Write down	(5,312)	-	(318,784)	(862,256)	(3,544)	-	(237,796)	(139,199)	(1,566,891)
Additions	12,652	-	20,918	339	-	-	1,679,373	59,438	1,772,720
Transfers	251,258	31,207	753,637	294,530	6,222	121,332	(1,782,235)	324,049	-
Disposals	(14,585)	-	(2,186)	(1,001)	(562)	(621)	(53)	(19,670)	(38,678)
Balance as of 31 December 2007	6,790,371	327,489	5,375,606	1,126,959	35,507	5,253,340	2,513,390	5,119,002	26,541,664
Accumulated depreciation									
Balance as of 1 January 2007	(3,169,332)	(221,092)	(2,716,670)	(1,401,509)	(25,397)	(4,721,134)	-	(3,423,537)	(15,678,671)
Elimination of accumulated depreciation	3,169,332	221,092	2,716,670	1,401,509	25,397	4,721,134	-	3,423,537	15,678,671
Charge for the period	(700,219)	(5,971)	(535,559)	(156,159)	(8,653)	(908,028)	-	(870,391)	(3,184,980)
Disposals	-	-	-	46	-	86	-	249	381
Balance as of 31 December 2007	(700,219)	(5,971)	(535,559)	(156,113)	(8,653)	(907,942)	-	(870,142)	(3,184,599)
Net book value as of 1 January 2007	4,656,090	65,833	4,373,491	1,670,317	22,932	2,290,787	2,100,722	1,515,690	16,695,862
Net book value as of 31 December 2007	6,090,152	321,518	4,840,047	970,846	26,854	4,345,398	2,513,390	4,248,860	23,357,065

Note 8. Property, plant and equipment (continued)

Construction in progress represents property, plant and equipment that have not been put into operation yet.

Depreciation of property, plant and equipment starts from the date of their commissioning.

Other property, plant and equipment include motor vehicles, computers, office furniture and other equipment.

Revaluation of property, plant and equipment. Starting from 1 January 2007 the Group has been accounting for property, plant and equipment at revalued amount (Note 4). The fair value was determined by independent appraisers on the basis of their depreciated replacement cost. The replacement cost of property, plant and transmission devices was estimated taking into account technical characteristics, cost of details and nature of construction. The replacement cost of equipment was determined based on the aggregated information about the replacement cost of combined heat and power stations, current deals and prices of producers and trading companies. The economic obsolescence was estimated based on profitability test results for each cash-generating unit. The discount rate used in the profitability test was 14.23% (except for Arkhangelsk branch where the discount rate used in the profitability test was 15.96%). The forecast period is 19 years. In the long-term perspective the sales will grow by approximately 3%.

As a result of performed revaluation equity of the Group increased by RR 7,355,775 thousand This amount represents the revaluation increase of RR 9,678,651 thousand less deferred tax liabilities of RR 2,322,876 thousand incurred in connection with this increase. The revaluation also resulted in the PP&E value write-down of RR 1,566,891 thousand which was duly recognized in the income statement. Finally the effect of revaluation of RR 7,355,775 was recognized within Other Reserves.

Net book value (without revaluation) of each group of property, plant and equipment that are stated at their revalued cost in these financial statements, are presented below:

	Factory building	Hydrotechnical constructions	Equipment and plant	Electric power substation and power equipment	Power lines and transmission facilities	Heat networks	Construction in progress	Other	Total
Net book value as of 31 December 2008	4,247,812	94,693	4,093,866	1,206,983	20,852	1,944,505	6,968,711	1,495,934	20,073,356
Net book value as of 31 December 2007	4,435,886	95,622	4,660,735	1,632,320	21,765	2,032,164	2,022,276	1,585,456	16,486,224

As of 31 December 2007 no property, plant and equipment of the Group were pledged under credit agreements.

As of 31 December 2008 property, plant and equipment with the collateral value of RR 2,013,113 thousand were transferred as security under loan agreements.

Impairment of property, plant and equipment as of 31 December 2008. As described in Note 2, the ongoing global financial and economic crisis continues to affect the Group, in particular:

- the financial crisis has resulted in a higher volatility of stock markets, severe reduction of liquidity in Russian economy and aggravated terms of raising funds in Russia;
- mid-term prognoses of such macroeconomic indicators as GDP and inflation index have changed significantly;
- decline in prices for commodities, in particular for oil, stable gas condensate, liquified gas and oil products is the evidence of the reduced demand from consumers;
- lower liquidity levels led to reduced production at some Russian entities and consequently to reduced demand for electricity;
- significant reduction of OJSC TGC-2's market capitalization in the fourth quarter 2008.

These developments have resulted in a change to the assumptions that were used to determine the value in use of the assets that comprise the cash generating units. Regional branches of OJSC TGC-2 were used as the relevant cash generating units.

Note 8. Property, plant and equipment (continued)

An impairment review has been carried out by comparing the recoverable amount of the individual cash generating units with their net book values. The recoverable amount was generally based on value in use, which was calculated based on estimated future cash flows using various assumptions including the following:

- Cash flows were projected based on actual operating results for 2008 and the business plan for 2009-2014;
- The values assigned to the key assumptions represent management's assessment of future trends in the business and are based on both external sources and internal sources;
- The forecast period for existent capacity is 18 years;
- Annual growth of electricity tariffs is estimated by the management to be in line with the average growth of fuel prices or in the range of 11% - 42% p.a. in 2009-2014 and in the range of 2% - 7% p.a. in 2015 and further;
- Annual growth of heat tariffs is estimated by the management in the part related to fuel which represents from 50% to 70% of the tariff and in the part related to direct component – at the level of inflation rates;
- Annual growth of gas prices is estimated by the management in the range of 11% - 42% p.a. in 2009-2014 and in the range of 2% - 7% p.a. in 2015 and further;
- Annual growth of coal prices is estimated by the management in the range of 9% - 25% p.a. in 2009-2014 and as 3% p.a. in 2015 and further;
- Annual growth of mazut prices is estimated by the management in the range of 10% -14% p.a. in 2009-2014 and as 4% p.a. in 2015 and further;
- Annual growth of other fuel prices is estimated by the management in the range of 9% -25% p.a. in 2009-2014 and in the range of 3% - 5% p.a. in 2015 and further;
- A pre-tax discount rate of 19.80% was applied in determining the recoverable amount of the plants.

The impairment loss recognised against two of the cash generating units is presented below:

	Total impairment loss	Charged to the Statement of Changes in Equity	Charged to the Income statement
Novgorod	(988,978)	(623,630)	(365,348)
Tver	(1,669,352)	(1,052,659)	(616,693)
Total	**(2,658,330)**	**(1,676,289)**	**(982,041)**

The following table as at 31 December 2008 presents sensitivity of impairment charge to reasonably possible changes in the post-tax discount rate applied at the balance sheet date relative to the impairment assumptions made by the Group, with all other variables held constant:

Discount rate	Yarolsavl	Arkhangelsk	Novgorod	Kostroma	Tver	Vologda	Total impact	Change
Change by -2%	-	-	(838,528)	-	(1,052,365)	-	(1,890,893)	-29%
Change by -1%	-	-	(918,854)	-	(1,378,900)	-	(2,297,753)	-14%
Change by +1%	(74,929)	-	(1,048,467)	-	(1,927,824)	-	(3,051,221)	15%
Change by +2%	(638,555)	-	(1,048,467)	-	(2,158,326)	-	(3,845,348)	45%

The impairment test resulted in an imparment loss of RR 2,658,330 thousand being recognised (as at 31 December 2007 – RR 0 thousand).

Operating lease. The Group leases a number of land areas owned by local governments under non-cancellable operating lease agreements. Lease payment is determined by lease contracts.

Note 8. Property, plant and equipment (continued)

The future aggregate minimum lease payments under non-cancellable operating leases are as follows:

	31 December 2008	31 December 2007
Under one year	209,214	171,578
From one to five years	1,080,000	529,881
Over five years	23,244,032	7,048,500
Total	24,533,246	7,749,959

Power stations, heat stations and other assets are located on land plots leased by the Group. Some lease agreements are concluded for 49 years, several contracts are concluded for one year with the prolongation right. Lease payments are reviewed for their compliance with market conditions on a regular basis.

Financial lease. As of 31 December 2008 and 2007 assets provided under the financial lease and included in the Other category of property, plant and equipment were as follows:

	31 December 2008	31 December 2007
Historical cost of assets leased under financial lease	138,154	164,735
Accumulated depreciation	(60,956)	(51,984)
Net book value	**77,198**	**112,751**

The table below presents financial lease maturity and minimal financial lease payments:

	31 December 2008	31 December 2007
Under one year	3,952	3,067
From one to five years	2,979	3,300
Over five years	155	155
Lease payments	**7,086**	**6,522**

Note 9. Other non-current assets

	Effective interest rate	31 December 2008	31 December 2007
Non-current loans receivable	12	13,739	16,821
Non-current accounts receivable (to be settled in 2009-2023)	12	5,918	353,474
Financial assets available for sale		27,317	
Total financial assets	-	**46,974**	**370,295**
Non-current input VAT (recoverable beyond 1 year of the reporting date)	-	190,672	13,109
Other	-	34,254	148,216
Other non-current assets		**271,900**	**531,620**

Non-current loans receivable represent loans that the Group provided to its employees for acquisition of residential premises at 12% p.a.

As a result of the RAO UES of Russia reorganization, OJSC TGC-2 Holding transferred to OJSC TGC-2 the shares of OJSC Irganayskaya HPP which in their turn were converted into the shares of OJSC RusHyrdo. These shares are quoted on the securities market (the equity stake of 0.1%). OJSC TGC-2 received 45,227,455 outstanding shares with a fair value of RR 1.9714 per share for the total sum of RR 89,161 thousand. Investments, the current market value of which can be determined on the established markets, are reported in the annual statements at their current market value. As of 31 December 2008 the value of OJSC RusHydro shares as per the MICEX quotes was RR 0.6040 per one share. Thus as of 31 December 2008 the difference between the carrying value and the market value of OJSC RusHydro shares amounted to RR 61,846 thousand and was included in other expenses of the Company, while the current market value of the shares was RR 27,317 thousand was recognized in the Balance sheet.

Note 10. Inventories

	31 December 2008	31 December 2007
Fuel	1,843,648	1,411,974
Spare parts	238,397	296,831
Other inventories	375,318	451,061
Total	**2,457,363**	**2,159,866**

Other inventories are presented net of an obsolescence provision of RR 2,454 thousand as of 31 December 2008 (as of 31 December 2007 there was no provision).

Inventory balances as of 31 December 2008 and 31 December 2007 include inventories of RR 1,040,976 thousand and RR 1,216,734 thousand, respectively, which were pledged in accordance with credit agreements.

Note 11. Accounts receivable and prepayments

	31 December 2008	31 December 2007
Trade receivables (net of provision for impairment of RR 1,930,941 thousand as at 31 December 2008 and RR 742,404 thousand as at 31 December 2007)	2,273,042	1,945,900
Other accounts receivable (net of provision for impairment of RR 148,707 thousand as at 31 December 2008 and RR 6,903 thousand as at 31 December 2007)	629,610	272,520
Total financial assets	**2,902,652**	**2,218,420**
Advances to suppliers (net of allowance for doubtful debtors of RR 20,532 thousand as at 31 December 2008 and RR 19,321 thousand as at 31 December 2007)	880,240	545,769
VAT recoverable	730,535	410,920
Prepayments to the budget (except for income tax)	294,922	52,777
Total	**4,808,349**	**3,227,886**

Management has determined the bad debt provision based on the specific customer identification, customer payment trends, subsequent receipts and settlements and analyses of expected future cash flows. The Group's management believes that the Group's entities will be able to realize the net receivable amount through direct collections and other non-cash settlements, and therefore, the recorded value approximates their fair value.

The Group analyzes credit risks associated with receivable (Note 2). The management of the Group analyzes receivables in accordance with the classification presented below. The management defines two principle classification types: receivables associated with electric power and heat power sales. Electric power is sold at the open and regulated market of electric power to companies who resell it further to final customers. Heat power is also sold to re-sellers and to final customers. From the credit risk perspective debtors of the above two types are similar enough.

Accounts receivable current and not impaired:

	31 December 2008	31 December 2007
Electric power	389,667	175,102
Heat power	1,364,308	773,817
Other accounts receivable	24,346	148,479
Total	**1,778,321**	**1,097,398**

As of 31 December 2008 trade and other receivables of RR 1,124,331 thousand (as of 31 December 2007 RR 1,121,022 thousand) are past due but not impaired. This is due to the fact that contractors are independent debtors with no history of failures to pay.

Note 11. Accounts receivable and prepayments (continued)

The ageing analysis of these trade receivables is shown in the table below:

Trade and other accounts receivable as of 31 December 2008, past due but not impaired:

	Under 3 months	3 - 6 months	6 - 12 months	1 – 5 years	Over 5 years	Total
Electric power	11,719	8,133	28,241	5,807	-	53,900
Heat power	212,712	114,811	126,863	10,782	-	465,168
Other accounts receivable	75,191	497,702	1,682	30,688	-	605,263
Total	**299,622**	**620,646**	**156,786**	**47,277**	**-**	**1,124,331**

Trade and other accounts receivable as of 31 December 2007, past due but not impaired:

	Under 3 months	3 - 6 months	6 - 12 months	1 – 5 years	Over 5 years	Total
Electric power	7,017	2,786	1,836	4,729	689	17,057
Heat power	598,522	36,321	215,057	130,023	-	979,923
Other accounts receivable	6,211	-	92,384	14,917	10,530	124,042
Total	**611,750**	**39,107**	**309,277**	**149,669**	**11,219**	**1,121,022**

The Group does not hold any collateral as security.

Trade and other receivables individually determined to be impaired (gross):

	31 December 2008	31 December 2007
Electric power	3,534	77,741
Heat power	1,927,407	664,663
Other accounts receivable	148,707	6,903
Total	**2,079,648**	**749,307**

A provision was formed with respect to all impaired trade and other receivables. The provision movement is presented as follows.

Impairment of trade and other accounts receivable:

	Year ended 31 December 2008	Year ended 31 December 2007
As of 1 January	749,307	1,352,474
Charge for the year	1,447,509	359,335
Uncollectible trade and other receivables write-off	(50,189)	(23,706)
Reversal of unused impairment provision	(66,979)	(938,796)
As of 31 December	**2,079,648**	**749,307**

Note 12. Cash and cash equivalents

	31 December 2008	31 December 2007
Cash with banks and on hand	186,413	234,068
Cash equivalents	-	202,000
Total	**186,413**	**436,068**

Note 12. Cash and cash equivalents (continued)

Balances of cash on hand and cash with banks

Cash on bank accounts and cash equivalents	Rating	Raiting agency	31 December 2008	31 December 2007
OJSC VTB Bank	BBB	Standard&Poor's	45,607	158,559
OJSC Transcreditbank	BB	Standard&Poor's	30,680	8,927
OJSC Sberbank	Baa1	Moody's	43,773	15,925
OJSC ROSBANK	BB+	Standard&Poor's	59,357	10
Other banks			6,996	50,647
Total			**186,413**	**234,068**

Cash equivalents include short-term "overnight" bank deposits.

Bank deposits	Rating	Raiting agency	31 December 2008	31 December 2007
OJSC VTB Bank	BBB	Standard&Poor's	-	202,000

Cash and cash equivalents are denominated in Russian Roubles.

Note 13. Other current assets

	31 December 2008	31 December 2007
Current promissory notes (effective interest rate of 10%, due to payment in 2010)	200,054	-

Bank promissory notes	Rating	Raiting agency	31 December 2008	31 December 2007
OAO Sberbank	Baa1	Moody's	200,054	-

Note 14. Equity

Basis of presentation of movement in equity. In 2006-2007 the Group was formed by the combination of a number of businesses under common control. Because of the application of the predecessor values method (see Note 2), the principal component of the Group's net equity represents the historical cost of net assets contributed to the Group in the course of the Group's reorganization as per the IFRS financial statements of the predecessor, rather than their fair value. As the Group was in fact formed as a result of several share issues completed after 1 January 2005, the statement of changes in equity reflects additions to share capital as of the corresponding dates in the amounts equal to the nominal value of shares issued, which in its turn is based on the fair value of contributed net assets. In accordance with the predecessor's book value basis, the effect of the above equity increase was compensated by a relevant increase of the merger reserve and decrease of the minority interest.

Shareholders' equity

	31 December 2008	31 December 2007
Number of ordinary shares, authorized, issued and paid up in full	1,458,401,856,250	1,095,996,358,137
Number of preference shares, authorized, issued and paid up in full	16,500,533,681	16,500,533,681
Nominal value (RR)	0.01	0.01
Total shareholders' equity (RR thousand)	**14,749,024**	**11,124,969**

Note 14. Equity (continued)

Movements of shares during the year were as follows (in number of shares):

	Ordinary shares	Preference shares	Total
At 1 January 2007	**700,328,533,458**	**11,384,171,043**	**711,712,704,501**
Shares issuance	395,667,824,679	5,116,362,638	400,784,187,317
At 31 December 2007	**1,095,996,358,137**	**16,500,533,681**	**1,112,496,891,818**
Shares issuance	360,000,000,000	-	360,000,000,000
Merger with OJSC TGC-2 Holding	2,405,498,113	-	2,405,498,113
At 31 December 2008	**1,458,401,856,250**	**16,500,533,681**	**1,474,902,389,931**

On 3 May 2007 the Company increased its share capital by RR 4,007,842 thousand by converting ordinary and preference shares of OJSC Arkhangelskaya GC into ordinary shares of OJSC TGC-2.

The share capital increased as a result of an additional issue by the way of public offering in April 2008. The Company issued 360,000,000,000 ordinary shares of RR 0.01 par value each for the total par value of RR 3,600,000 thousand. Total cash received from the transaction was RR 9,000,000 thousand (RR 5,400,000 thousand of share premium less RR 105,014 thousand of expenses on the additional issues).
The share capital was also increased as a result of the merger of OJSC TGC-2 Holding and OJSC TGC-2 (Note 1).

Ordinary and preference shares. Preference share can not be converted into ordinary shares or redeemed. In total the preference dividend may not be less than the ordinary dividend and is not cumulative. Preference shares carry no voting rights except for situations when annual shareholders meeting has not decided on dividends payment or decided on partial dividends payments. In liquidation preference shareholders are first paid any declared unpaid dividends, then the liquidation value of the shares, and after that the remaining assets are distributed equally to preference and ordinary shares.

Treasury shares. In 2008, the Group repurchased 300,043,370 ordinary shares and 1,579,684,034 preferred shares at a price exceeding the nominal value. The consideration paid in the amount of RR 33,625 thousand for the purchase of these shares is accounted for as a deduction from capital (treasury shares).

Pursuant to the reorganization described in Note 1, shares of OJSC TGC-2 in the amount 9,931,097,957 owned by RAO UES of Russia were contributed to the share capital of OJSC TGC-2 Holding. On the same date OJSC TGC-2 merged with OJSC TGC-2 Holding. As a result, OJSC TGC-2 Holding ceased to exist and shares of OJSC TGC-2 Holding in the amount of 13,946,272,441 were converted into 12,636,630,440 Company's shares. The Company issued 2,405,498,113 ordinary shares (RR 24,055 thousand) and 300,043,370 treasury shares (RR 6,198 thousand) in the conversion process.

As at 31 December 2008, the number of treasury shares amounted to 1,579,684,034 shares.

Merger reserve. The difference of RR 2,750,197 thousand as of 1 January 2008 between the nominal value of shareholders' equity and the IFRS carrying value of contributed assets has been recognized as a merger reserve within equity.

Dividends. The statutory accounting reports of the Group are the basis for profit distribution and other appropriations. The Russian legislation identifies the basis of distribution as the net profit. However, this legislation and other statutory laws and regulations dealing with the distribution rights are open to legal interpretation and, accordingly, management believes at present it would not be appropriate to disclose the amount for the distributable reserves in these financial statements. Accordingly, management believes that currently it would not be appropriate to disclose the distributable reserves in these financial statements.

In 2008 the Group did not announce any payment of dividends.

Provision for buy out of treasury shares. In connection with the reorganisation described in Note 1, as of 31 December 2007 the Company formed a provision to fund the buy out of shares for the total amount of RR 33,625 thousand, as in accordance with the Russian legislation shareholders who voted against the reorganisation or did

Note 14. Equity (continued)

not participate in the voting had the right to claim that the Company should buy out their shares within 45 days from the date of the general shareholders meeting and at a predetermined share repurchase price.

As described above, the Company acquired 300,043 thousand common shares and 1,579,684 thousand preferred shares in 2008 at a cost of RR 33,625 thousand.

Other reserves. As at 31 December 2008 other reserves include the revaluation reserve for property, plant and equipment (net of related deferred tax) at the amount of RR 3,482,147 thousand reduced during the reporting period for the release of the revaluation reserve and impairment of property, plant and equipment; as at 31 December 2007 other reserves included the revaluation reserve for property, plant and equipment (net of related deferred tax) at the amount of RR 5,892,468 thousand less provision for buy-out of treasury shares at the amount of RR 33,625 thousand.

Note 15. Income tax

	Year ended 31 December 2008	Year ended 31 December 2007
Current income tax benefit/(expense)	33,162	(191)
Deferred tax income benefit	1,069,044	642,739
Total income tax benefit	**1,102,206**	**642,548**

During the years ended 31 December 2008 and 2007 the Group entities were subject to a 24% income tax rate on taxable profits.

20 November 2008 the Government of the Russian Federation amended the legislation by decreasing the income tax rate from 24% to 20% with effect from 1 January 2009.

This amendment on the change of the income tax rate was adopted before 31 December 2008, therefore an effect of RR 68,490 thousand from the decreased in the net deferred tax liability was recognized in the financial statements of the Group.

Reconciliation of theoretical and actual income tax is as follows:

	Year ended 31 December 2008	Year ended 31 December 2007
Loss before tax	**(5,839,433)**	**(2,478,914)**
Theoretical tax benefit at the statutory tax rate of 24% and 20%	1,401,464	594,939
Effect of expenses which are not deductible for taxation purposes	(382,082)	47,609
Effect of applying different rates (tax on dividends – 9%)	4,800	-
Effect of changes in income tax rates	78,024	-
Total income tax	**1,102,206**	**642,548**

Deferred tax assets and liabilities

Differences between the 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, on the one hand, and for income tax purposes, on the other hand. Deferred tax assets and liabilities are measured at the rate of 24 percent as of 31 December 2007 and at the rate of 20 percent as of 31 December 2008 which were the rates expected to be applied when the assets were realized and liabilities are settled.

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

Note 15. Income tax (continued)

	31 December 2007	Subsidiary acquisition	Movement for the year recognized in the Income Statement	Movement for the year recognized in the Statement of Changes in Equity	31 December 2008
Tax loss	420,595	-	140,522	-	561,117
Accounts receivable and prepayments	67,327	70,843	35,150	-	173,320
Other non-current assets	99,765	-	(98,495)	-	1,270
Accounts payable and accrued liabilities	61,064	-	31,135	-	92,199
Pension liabilities	82,292	3,895	(7,456)	-	78,731
Other	-	2,408	41,146	-	43,554
Deferred tax assets	**731,043**	**77,146**	**142,002**	**-**	**950,191**
Property, plant and equipment	(3,809,291)	(63,629)	886,351	609,634	(2,376,935)
Other	(24,580)	(16,111)	40,691	-	-
Deferred tax liabilities	**(3,833,871)**	**(79,740)**	**927,042**	**609,634**	**(2,376,935)**
Net deferred tax liabilities	**(3,102,828)**	**(2,594)**	**1,069,044**	**609,634**	**(1,426,744)**

	31 December 2006	Movement for the year recognized in the Income Statement	Movement for the year recognized in the Statement of Changes in Equity	31 December 2007
Tax loss	589,208	(168,613)	-	420,595
Accounts receivable, prepayments and other non-current assets	291,295	(124,203)	-	167,092
Accounts payable and accrued liabilities	37,645	23,419	-	61,064
Pension liabilities	50,121	32,171	-	82,292
Other	5,983	(5,983)	-	-
Deferred tax assets	**974,252**	**(243,209)**	**-**	**731,043**
Property, plant and equipment	(2,384,129)	897,714	(2,322,876)	(3,809,291)
Other	(12,814)	(11,766)	-	(24,580)
Deferred tax liabilities	**(2,396,943)**	**885,948**	**(2,322,876)**	**(3,833,871)**
Net deferred tax liabilities	**(1,422,691)**	**642,739**	**(2,322,876)**	**(3,102,828)**

In deferred tax calculation the Group recognizes tax losses as a deferred tax asset. The Group's management believes these tax losses will be utilized in the nearest future, and the Group will receive tax profit, which is also due to the fact that TPPs and boiler plants of the Arkhangelsk branch started using gas instead of mazut as fuel.

Note 16. Pension liabilities

Pension contributions recognized in the balance sheet are as follows:

	31 December 2008	31 December 2007
Defined benefit obligations	829,645	688,150
Unrecognised net actuarial losses	(380,626)	(281,321)
Unrecognised past service cost	(55,361)	(63,944)
Net liability in the balance sheet	**393,658**	**342,885**

Note 16. Pension liabilities (continued)

Amounts recognized in the Income statement:

	Year ended 31 December 2008	Year ended 31 December 2007
Current service cost	34,953	35,010
Interest cost	46,199	28,127
Net actuarial losses recognized in period	17,165	-
Amortization of past service cost	5,976	5,976
Settelment gain	(17,774)	-
Termination benefit	8,399	-
Immediate recognition of vested prior service cost	-	116,479
Total	**94,918**	**185,592**

Changes in the present value of defined pension obligations of the Group are presented below:

	Year ended 31 December 2008	Year ended 31 December 2007
Pension liabilities		
Pension liability at the beginning of the year	688,150	288,821
Pension liability transferred under TKS acquisition (Note 6)	16,486	-
Service cost	34,953	35,010
Interest cost	46,199	28,127
Past service cost	-	131,780
Pensions paid	(51,974)	(40,975)
Actuarial losses	134,126	245,388
Settlement and reduction of liabilities due to curtailment	(38,295)	
Pension liability at the end of the year	**829,645**	**688,151**

Principal actuarial assumptions are as follows:

	Year ended 31 December 2008	Year ended 31 December 2007
Discount rate on benefits at the accumulation stage	9.0%	6.75%
Future salary increases	8.0%	7.0%
Inflation rate	7.0%	6.0%

Note 17. Borrowings

Non-current borrowings

Creditor	Currency	Effective Interest rate, %	31 December 2008	31 December 2007
OJSC Sberbank RF	(RR)	10-11	910,000	670,000
Total non-current borrowings			**910,000**	**670,000**

Note 17. Borrowings (continued)

Current borrowings

Creditor	Currency	Effective Interest rate, %	31 December 2008	31 December 2007
Bonded loan	(RR)	10.95	3,087,050	-
OJSC Sberbank RF	(RR)	9	1,384,702	1,297,600
OJSC Rosbank	(RR)	9 - 16	1,317,611	2,000,000
OJSC TransCreditBank	(RR)	15	896,601	11,300
ACB Bank of Moscow	(RR)	9	300,000	-
OJSC Vneshtorgbank	(RR)	11	-	1,500,000
OJSC Vnesheconombank	(RR)	9	-	1,000,000
OJSC Nomosbank	(RR)	10.75	-	200,000
Other	(RR)		111,134	-
Total current borrowings			**7,097,098**	**6,008,900**

In September 2008 the Company issued bonds for the amount of RR 3,087,050 thousand. The coupon rate for the first and second coupon periods was 10.95% p.a. (Note 2). The bonds are not publicity traded.

Inventories and property, plant and equipment are used as security under loan agreements (Notes 8,10).

The effective rate is represented by the market rate applicable to the loan as of the receipt date.

The Group has not entered into any hedging arrangements in respect of its interest rates exposure.

Note 18. Accounts payable and accruals

	31 December 2008	31 December 2007
Trade accounts payable	1,031,069	1,454,638
Accruals and other accounts payable	627,998	66,292
Dividends payable	13,521	15,325
Total financial liabilities	**1,672,588**	**1,536,255**
Payroll payable	300,844	329,861
Advances received	185,129	270,244
Advances for capital construction	-	181,812
Total	**2,158,561**	**2,318,172**

Trade payables are classified as financial liabilities. As of 31 December 2008 total financial liabilities were RR 9,679,686 thousand (as of 31 December 2007 - RR 8,215,155 thousand) and include apart from trade payables current and non-current borrowings (Note 17).

Management believes that majority of suppliers settlements with which are included in trade payables represent one group as they have similar characteristics. These suppliers primarily provide repair and technical maintenance services.

Note 19. Taxes other than profit tax

	31 December 2008	31 December 2007
Value Added Tax	105,560	117,663
Unified social tax	60,407	101,637
Property tax	45,736	50,025
Environmental fees	31,174	-
Water tax	7,672	19,266
Other taxes	27,559	51,445
Total	**278,108**	**340,036**

VAT represents the deferred value added tax to be payable if corresponding accounts receivable are settled or written off.

Note 20. Revenue

	Year ended 31 December 2008	Year ended 31 December 2007
Heating power	10,684,636	9,879,178
Electricity power	8,215,259	8,884,809
Capacity	3,205,309	1,042,711
Heating power transmission	540,988	387,658
Water circulation	270,570	256,768
Other income	246,079	343,667
Total current revenue	**23,162,841**	**20,794,791**

Approximately 2% of annual electric power sales for 2008 relate to resale of power purchased on NOREM wholesale market (for 2007 it was 3%).

Note 21. Operating expenses

	Year ended 31 December 2008	Year ended 31 December 2007
Fuel expenses	14,792,062	11,244,389
Payroll and payroll taxes	3,001,200	2,787,395
Depreciation of property, plant and equipment	2,538,283	3,184,956
Impairment charge/(release) of accounts receivable	965,929	(584,782)
Purchased electricity and capacity	612,840	472,713
Gas transportation expenses	557,902	388,608
Repairs and maintenance	470,888	1,130,922
Water usage	463,947	279,959
Third parties services	463,741	488,660
Expenses on feedstock and materials	460,489	401,506
Purchased heat for resale	421,962	-
Contingent liabilities provision (Note 25)	415,913	-
Taxes other than income tax	377,004	225,541
Rental expenses	230,949	205,298
Heat transportation expenses	203,686	98,999
Disposal of assets	197,191	12,420
NOREM services	176,792	122,735
Security services	156,558	135,554
Advisory services	139,045	75,551
Transportation services	127,931	141,667
Impairment charge for available-for-sale financial assets	61,846	-
Energy fund membership payments	55,000	-
Charity expenses	41,160	1,977
Payments to the energy saving funds	39,246	24,929
Insurance expenses	37,930	68,724
Effect on discounting of non-current account receivable	-	150,236
Other expenses	505,142	357,374
Total operating expenses	**27,514,636**	**21,415,331**

Note 22. Financial expenses

	Year ended 31 December 2008	Year ended 31 December 2007
Interest expense	589,207	493,239
Interest expense on pension liabilities (Note 16)	46,199	28,127
Interest expense (leasing)	1,905	4,264
Total	**637,311**	**525,630**

Note 23. Earnings per share

	Year ended 31 December 2008	Year ended 31 December 2007
Weighted average number of ordinary shares outstanding during the year (in thousand shares)	1,335,238,466	973,745,892
Weighted average number of preference shares outstanding during the year (in thousand shares)	16,500,534	3,392,219
Weighted average number of ordinary and preference shares outstanding during the year (in thousand shares)	1,351,739,000	977,138,111
Loss attributable to shareholders of OJSC TGC-2	(4,783,931)	(1,658,044)
Weighted average loss per ordinary and preference share – basic and diluted (RR)	(0.004)	(0.002)

Note 24. Commitments

Sales Commitments. The Group entities sell electric power (capacity) in the regulated trading sector and free trading sector of the wholesale market. On the regulated sector contracts are signed mainly with sales companies. Tariffs for electric power (capacity) sold under regulated delivery contracts are set by the Federal Service on Tariffs. For the purpose of fulfilling obligations under regulated contracts it is possible to buy electric power in the free trading sector under contracts with CJSC Financial Settlements Centre (CJSC FSC).

Short-term contracts with CJSC FSC, sales companies and major contractors were concluded for the sale of electric power (capacity) (not covered by regulated contracts) in the free trading market.

Capital commitments. Future capital expenditures for which contracts have been signed, amount to RR 9,573,454 thousand and RR 1,501,823 thousand as of 31 December 2008 and 2007, respectively.

Note 25. Contingencies

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

Insurance. The Group ensures certain assets, transactions, civil responsibility and other insurable risks. Accordingly, the Group is exposed to those risks for which it does not have insurance.

Legal proceedings. The Group entities are party to certain legal proceedings arising in the ordinary course of business. According to management of the Group, there are presently no claims or suits against the Group (and those, which already have a final decision thereupon) which could potentially have an adverse effect on the financial position of the Group.

Taxation. The Russian tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to transactions and activity of the Group may be challenged by the relevant regional and federal authorities, in particular the way of water tax calculation and settlement via agents. 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

Note 25. Contingencies (continued)

by the authorities in respect of taxes for three calendar years preceding the year of the tax audit. Under certain circumstances reviews may cover longer periods.
The legislation, including tax legislation, does not cover all aspects of the group's reorganisation, therefore certain legal and tax risks may still exist.

Management believes that its interpretation of the relevant legislation is appropriate and the Group's tax, currency and customs positions will be sustained as of 31 December 2008. Where management believes it is probable that the Group's position cannot be sustained, an appropriate amount has been accrued for in the financial statements.

In addition, the tax and other legislation do not describe all specific aspects of the Group's reorganization related to the power industry restructuring. Therefore, tax and legal disputes may arise related to different interpretations, operations and decisions that were part of the reorganization and reformation process.

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

Contingency provision. The Company formed a contingency provision for litigations that have not been completed as of the reporting date. As of 31 December 2008 the provision amounted to RR 415,913 thousand (as of 1 January 2008 there was no provision).

The contingent provision is as follows:

	31 December 2008	31 December 2007
Current litigation claims	178,244	-
Tax provision	104,869	-
Claims under joint responsibility	92,187	-
Claims for unjust enrichment	37,499	-
Other	3,114	-
Total contingent provision	**415,913**	**-**

Note 26. Financial instruments and financial risk factors

Financial risk factors. The Group activities are subject to various risks, including changes in interest rates and collectability of receivables. The Group does not have a risk policy to hedge its financial exposures.

Electric power (capacity) and heating power produced by the Group entities are sold on the Russian Federation domestic market at fixed prices denominated in the Russian Federation currency. Therefore the risk associated with currency exchange rate changes is not significant for the Group. Financial position of the Group, its liquidity, financial resources and performance are not significantly impacted by changes in currency exchange rates as activities of the Group are carried out in such a way that all its assets and liabilities are denominated in the national currency.

Credit risk. The credit risk represents the risk of a financial loss that the Group can incur due to a default by the Group contractors on their financial instrument obligations to the Group.

Cash is placed in financial institutions, which are considered at the time of the deposit to have minimal risk of default. The Group's assessment of banks' financial position is based on ratings of independent agencies and other factors.

Note 26. Financial instruments and financial risk factors (continued)

Despite the fact that some banks and companies do not have any international credit ratings, management of the Group views them as reliable contractors who have stable position in the Russian market and meet generally accepted criteria of credit status and financial stability.

Liquidity risk. Prudent liquidity risk management includes maintaining sufficient level of cash and availability of funding.

The table below presents analysis of obligations of the Group by maturity dates. The payable amount represents the undiscounted amount of cash flows under contract. Balances payable within 12 months are expected to be equal to the current balances due to insignificant impact of discounting.

	Under 1 year	1 - 2 years	2-5 years	over 5 years
As of 31 December 2008				
Borrowings	7,097,098	670,000	240,000	-
Trade and other accounts payable	2,158,561	-	-	-
As of 31 December 2007				
Borrowings	6,008,900	-	803,530	-
Trade and other accounts payable	2,318,172	-	-	-

Interest rate risk. The Group's cash flows from operating activity are independent from changes in market interest rates. The largest part of the Group's long-term and short-term borrowings are at fixed interest rates. If market interest rates for newly raised loans increase, the Company amends its financial plans, deferring costs and payments that do not impact the reliability of electric equipment, thus compensating the increase of current loan expenses. Additional loan interest expenses as a result of growing interest rates that have not been considered in the current period tariffs can be included in tariffs negotiated fee.

The majority of the Group's long-term and short-term borrowings are at fixed interest rates as described in Note 17.

Capital management. The following capital requirements have been established for joint stock companies by the legislation of the Russian Federation:

- share capital can not be lower than 1,000 minimum salaries on the date of the company registration;
- if the shareholders' capital of the entity is greater than statutory net assets of the entity, such entity must decrease its share capital to the value not exceeding its net assets;
- if the minimum allowed share capital is greater than statutory net assets of the entity, such entity is subject to liquidation.

As at 31 December 2008 the Group was in compliance with the above shareholders' capital requirements.

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

In order to maintain or adjust the capital structure, the Group may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares or sell assets to reduce debt.

The Group monitors capital on the basis of the statutory gearing and leverage ratios. In the year ended 31 December 2008 the Group's strategy remained unchanged since 2006 and was to ensure that the leverage ratio is not more than 40% and the capitalisation ratio is at least 1.5. As of 31 December 2008 and 2007 the above ratios were as follows:

Note 26. Financial instruments and financial risk factors (continued)

	31 December 2008	31 December 2007
Leverange ratio	53%	57%
Capitalisation ratio	0.59	0.74

Classification of financial instruments. IFRS 39 Financial Instruments: Disclosures classifies financial instruments into the following categories: a) loans and receivables; b) financial assets available for sale; c) financial assets held to maturity; d) financial assets at fair value through profit and loss.

Financial assets, which potentially subject the Group entities to credit risk, are presented below:

	Loans and accounts receivable	Financial assets available for sale	Financial assets designated at fair value through profit or loss	Total
ASSETS				
Other non-current assets (Note 9)				
Non-current loans receivable	*13,739*	-	-	*13,739*
Non-current accounts receivable	*5,918*	-	-	*5,918*
Financial assets available for sale		*27,317*	-	*27,317*
Accounts receivable and prepayments (Note 11)		-	-	-
Trade accounts receivable	*2,273,042*	-	-	*2,273,042*
Other accounts receivable	*629,610*	-	-	*629,610*
Other current assets (Note 13)	-	-	200,054	200,054
Cash and cash equivalents (Note 12)	186,413	-	-	186,413
Total financial assets	3,108,722	27,317	200,054	3,336,093
Total non-financial assets				29,006,460
TOTAL ASSETS	**3,108,722**	**27,317**	**200,054**	**32,342,553**

Fair value. Management of the Group believes that the fair value of financial assets and financial liabilities approximates their carrying value, except for bonded loan which fair value is less than carrying value by RR 228,650 thounsand (also see Note 2).

The carrying value less impairment provision of trade receivables and payables are assumed to approximate their fair values due to the short-term nature of trade receivables.

Bank deposits of the Group are short-term and their carrying value approximates their fair value.

The maximum exposure for each risk is limited to the fair value of each class of financial instrument.

Note 27. Subsequent Events

In February 2009 the Company sold treasury shares that had been bought out earlier from shareholders at market price. The amount of proceeds was RR 23 million lower than its carrying value (see Note 14).