OJSC VOLGA TGC

COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS,
PREPARED IN ACCORDANCE WITH INTERNATIONAL FINANCIAL
REPORTING STANDARDS (IFRS) FOR THE YEARS
ENDED 31 DECEMBER 2006 AND 2005

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Independent Auditors' Report

To the board of directors of
OJSC Volga TGC

Report on the Combined and Consolidated Financial Statements

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

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these combined and consolidated financial statements based on our audit. Except as described in the Basis for Qualified Opinion paragraph, we conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free of 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 principles used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

ZAO KPMG, a company incorporated under the Laws of the Russian Federation and a member firm of the KPMG network of independent member firms affiliated with KPMG International, a Swiss cooperative.

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

Basis for Qualified Opinion

We did not observe the counting of inventories stated at RR 1,377,944 thousand and RR 486,788 thousand as at 31 December 2005 and 2004, accordingly, because we were engaged as auditors of the Group only after those dates. It was impracticable to satisfy ourselves as to those inventory quantities by other audit procedures. Accordingly, we were unable to determine whether any adjustments might be necessary to cost of sales, taxation expense and net profit for the year ended 31 December 2006 and to cost of sales, taxation expense, net profit and retained earnings for the year ended 2005.

Qualified Opinion

In our opinion, except for the effects of such adjustments, if any, that might have been determined to be necessary had it been practicable to obtain sufficient appropriate audit evidence as described in the Basis for Qualified Opinion, the combined and consolidated financial statements present fairly, in all material respects, the combined and consolidated financial position of the Group as at 31 December 2006 and 2005, and its combined and consolidated financial performance and its combined and consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards.

Emphasis of Matter

The combined and consolidated financial statements have been prepared for the purpose of presenting the combined and consolidated financial position, combined and consolidated financial performance and combined and consolidated cash flows of certain companies under common control as if a restructuring that was completed in July 2007 had taken place before 1 January 2005. The restructuring and the basis of preparation is described in Notes 1 and 3.

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2 November 2007

	Notes	31 December 2006	31 December 2005
ASSETS			
Non-current assets			
Property, plant and equipment	5	35,012,992	35,550,069
Intangible assets	6	560,566	192,332
Deferred tax assets	22	474,003	530,981
Other non-current assets	7	572,562	532,634
Available-for-sale financial assets	8	365,616	359,149
Total non-current assets		**36,985,739**	**37,165,165**
Current assets			
Cash	9	967,196	340,802
Accounts receivable and prepayments	10	2,516,743	683,091
Income tax receivable		90,812	-
Value added tax recoverable		294,935	606,137
Available-for-sale financial assets	8	75,878	112,788
Inventories	11	2,693,645	1,377,944
Non-current assets held for sale	12	-	245,952
Total current assets		**6,639,209**	**3,366,714**
TOTAL ASSETS		**43,624,948**	**40,531,879**
EQUITY AND LIABILITIES			
Equity			
Ordinary shares (nominal value RR 26,116,076 thousand)	13	26,116,076	26,116,076
Additional paid in capital	13	1,587,056	1,587,056
Retained earnings and other reserves		2,638,999	2,491,873
TOTAL EQUITY		**30,342,131**	**30,195,005**
Non-current liabilities			
Deferred tax liabilities	22	5,384,237	5,975,943
Loans and finance lease liabilities	14	514	91,806
Promissory notes	15	220,780	269,035
Provisions for liabilities and charges	16	1,284,650	1,101,112
Other non-current liabilities		12	98,446
Total non-current liabilities		**6,890,193**	**7,536,342**
Current liabilities			
Loans and finance lease liabilities	14	2,885,052	472,999
Accounts payable and accrued charges	17	1,948,082	1,159,791
Income tax payable		177,776	81,994
Promissory notes	15	128,808	47,940
Provisions for liabilities and charges	16	29,020	10,145
Other taxes payable	18	1,223,886	1,027,663
Total current liabilities		**6,392,624**	**2,800,532**
TOTAL LIABILITIES		**13,282,817**	**10,336,874**
TOTAL EQUITY AND LIABILITIES		**43,624,948**	**40,531,879**

These combined and consolidated financial statements were approved by the management of the Group on 2 November 2007 and were signed on its behalf by:

General Director V.V. Nikonov
Chief Accountant A. F. Varenov.

Открытое акционерное общество «Волжская территориальная генерирующая компания» г. Самара
ОАО «Волжская ТГК»

	Note	Year ended 31 December 2006	Year ended 31 December 2005
Revenues	19	34,300,600	29,165,136
Operating expenses	20	(33,998,401)	(29,313,913)
Operating profit		**302,199**	**(148,777)**
Other income		122,915	306,617
Net finance expense	21	(100,178)	2,154
Profit before income tax		**324,936**	**159,994**
Income tax expense	22	(180,709)	(31,324)
Net profit for the year		**144,227**	**128,670**
Basic earnings per ordinary share in Russian rubles	23	0.0055	0.0049

	Year ended 31 December 2006	Year ended 31 December 2005
CASH FLOW FROM OPERATING ACTIVITIES		
Profit before income tax	**324,936**	**159,994**
Adjustments for:		
Depreciation	2,475,095	2,261,684
Amortisation of intangible assets	37,151	2,798
Loss on disposal of property, plant and equipment	960	-
Increase in liability for defined benefit plans	183,538	-
Net finance expense	100,178	(2,154)
Provision for impairment of accounts receivable	(148,332)	287,686
Reserve for obsolescence	38,431	27,024
Gain on sale of non-current assets held for sale	(15,048)	-
Operating cash flows before changes in working capital and profit tax paid	**2,996,909**	**2,737,032**
Increase in trade and other receivables	(1,266,784)	(1,281,139)
Increase in inventories	(1,354,132)	(579,310)
Increase in other current assets	(76,079)	(28,659)
Increase in trade and other payables	982,220	1,246,739
Interest paid	(109,329)	(8,568)
Income tax paid	(710,385)	(393,643)
Net cash from operating activities	**462,420**	**1,692,452**
CASH FLOW FROM INVESTING ACTIVITIES		
Acquisition of property, plant and equipment	(1,876,026)	(1,631,225)
Acquisition of intangible assets and other non-current assets	(503,629)	(195,130)
Proceeds from sale of property, plant and equipment	5,852	-
Interest received	11,118	1,153
Acquisition of available-for-sale financial assets	(589,284)	-
Repayment of available-for-sale financial assets	658,528	-
Proceeds from sale of non-current assets held for sale	261,000	-
Net cash used in investing activities	**(2,032,441)**	**(1,825,202)**
CASH FLOW FROM FINANCING ACTIVITIES		
Proceeds from borrowings	5,965,877	473,552
Repayment of borrowings	(3,742,237)	-
Payment of finance lease liabilities	8,678	-
Dividends paid	(35,903)	-
Net cash from financing activities	**2,196,415**	**473,552**
Increase in cash and cash equivalents	**626,394**	**340,802**
Cash at the beginning of the year	**340,802**	**-**
Cash at the end of the year	**967,196**	**340,802**

	Share capital	Additional paid in capital	Available-for-sale financial assets revaluation reserve	Retained earnings	Total equity
Balance as at 1 January 2005	**26,116,076**	**1,587,056**	**-**	**2,461,803**	**30,164,935**
Changes in fair value of available-for-sale financial assets	-	-	(98,600)	-	**(98,600)**
Net loss recognized directly in equity	-	-	(98,600)	-	**(98,600)**
Net profit for the year	-	-	-	128,670	**128,670**
Total recognized income for the year	-	-	(98,600)	128,670	**30,070**
Balance as at 31 December 2005	**26,116,076**	**1,587,056**	**(98,600)**	**2,590,473**	**30,195,005**
Changes in fair value of available-for-sale financial assets	**-**	**-**	38,802	-	**38,802**
Net income recognized directly in equity	-	-	38,802	-	**38,802**
Net profit for the year	-	-	-	144,227	**144,227**
Total recognized income for the year	-	-	38,802	144,227	**183,029**
Dividends	-	-	-	(35,903)	**(35,903)**
Balance as at 31 December 2006	**26,116,076**	**1,587,056**	**(59,798)**	**2,698,797**	**30,342,131**

Note 1. The Group and its operations

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

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

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

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

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

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

Russian business environment

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

Relations with the state and regulation of the Group

As at 03 July 2007, the date of completion of the final stage of the Company's reorganization, the following shareholders owned OJSC Volga TGC: RAO UES of Russia (54%), CJSC Deposit-clearing company (33%), other minority shareholders (13%). RAO UES of Russia ("the Parent") is the controlling shareholder of the Group. As at 31 December 2005 and 2006, the Government of the Russian Federation owned 52.7% of RAO UES of Russia.

Among the consumers of electricity and heat power of the Group are key entities controlled by, or related to, the state. Furthermore, the state controls a number of the Group's fuel and other suppliers (see Note 24).

The government of the Russian Federation directly affects the Group's operations through regulation by the Federal Service on Tariffs ("FST"), with respect to its wholesale energy sales, and by the regional services on tariffs ("RSTs"), with respect to its retail electricity and heat sales. The operations of all generating facilities are coordinated by JSC System Operator – Central Despatch Unit of Unified Energy System ("SO-CDU") in order to meet system requirements in an efficient manner. SO-CDU is controlled by RAO UES of Russia.

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

Note 1. The Group and its operations (continued)

Sector restructuring

The Russian electric utilities industry in general and the Group in particular are presently undergoing a reform process designed to introduce competition into the electricity sector and to create an environment in which the Group can raise the capital required to maintain and expand current capacity.

A crucial step in developing a competitive wholesale electricity (capacity) market was the adoption of the new Wholesale Electric Power (capacity) Market (NOREM) Rules of the Transitional Period approved by Resolution of the Government of the Russian Federation No. 529 dated August 31, 2006 and which came into force on September 1, 2006. Under the new wholesale market framework, electricity and power purchase-and-sale transactions in the regulated market sector are to be governed by a regulated bilateral contract system. From 1 September 2006, regulated contracts covered all volumes of electricity and power produced and consumed.

From 2007 volumes of electricity (power) traded in the wholesale market at regulated prices will substantially reduce. The pace of reduction will be set annually by the Russian Federation Government according to socio-economic development forecasts. In 2007 up to 95% of the forecasted production volumes will be traded at regulated prices. In 2013 it will become possible to launch a fully competitive whole sale market.

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

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

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

Restructuring of the Group

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

In April 2007, the Parent transferred 100% of the shares of Orenburg TGC to the Company in exchange for additional shares issued by the Company solely for this purpose as part of the overall restructuring of the Group (see Note 13).

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

In accordance with its accounting policy as at and for the years ended 31 December 2005 and 2006, the Group presented combined and consolidated financial statements as if the restructuring described above had been completed prior to 1 January 2005 and the Group had been engaged in its own heat and electricity activities as of that date. Accordingly, the heat and electric generation business activities, representing components of the founders’ businesses, were combined and presented as the Group’s own generating activities. In addition, Orenburg TGC was consolidated for all periods presented as if it became the subsidiary of the Company prior to 1 January 2005 and the results of operations of Orenburg TGC were included in the consolidated results of operations of the Group for 2005 and 2006.

Note 2. Financial conditions

As discussed above the Group is affected by the Government through control of tariffs and other factors. The FST and RSTs do not always permit tariff increases in line with increases in the Group's costs and thus some tariffs are insufficient to cover all the costs of generation and distribution. Moreover, these tariffs consider costs only on the Russian statutory basis and, accordingly, exclude additional costs recognized under the International Financial Reporting Standards ("IFRS"). As a result, tariffs may not consistently allow for an adequate return on investment and currently do not provide sufficient funds for the full replacement of property, plant and equipment. However, in 2006 and to date in 2007, the growing demand for electricity and capacity together with

Note 2. Financial conditions (continued)

increasing free trading sector of the wholesale electricity market have resulted in a higher rate of revenue growth (see Sector restructuring in Note 1).

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

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

Note 3. Basic approaches for financial statements preparation

Statement of compliance

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

Basis of measurement

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

Functional and presentation currency

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

Use of judgments, estimates and assumptions

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

Impairment provision for accounts receivable

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

Tax contingencies

Russian tax legislation often contains contradictory formulating and interpretations and is a subject to frequent changes. In cases, when in management opinion their interpretation of tax laws is different to tax authorities, provision is made in financial statement.

Property, plant and equipment

Fair value of property, plant and equipment as at 1 January 2005 has been determined by an independent appraiser based on the depreciated replacement cost method as well as estimated income. As described in Note 6 the determination of fair value is based on management assessment of future growth in sales and production. Further, management assesses the useful lives of property, plant and equipment based upon experience with similar assets. In determining the useful life of an asset, management considers the expected usage, estimated technical obsolescence, physical wear and tear and the physical environment in which the asset is operated. Carrying value and depreciation of property, plant and equipment are significantly affected by the above

Note 3. Basic approaches for financial statements preparation (continued)

estimates, and actual results may differ from those estimates. Any changes to these estimates may have significantly impact on these combined and consolidated financial statements.

Note 4. Summary of significant accounting policies

4.1 Basis of consolidation

Subsidiaries

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

Transactions among entities under common control

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

Associates

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

Transactions eliminated on consolidation

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

4.2 Foreign currency

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

4.3 Non-derivative financial instruments

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

Note 4. Summary of significant accounting policies (continued)

4.3 Non-derivative financial instruments (continued)

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

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

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

Held-to-maturity investments

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

Available-for-sale financial assets

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

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

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

Investments at fair value through profit or loss

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

Other

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

Fair value disclosure

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

Note 4. Summary of significant accounting policies (continued)

4.4 Property, plant and equipment

Recognition and measurement

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

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

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

Subsequent costs

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

Depreciation

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

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

4.5 Intangible assets

Research and development

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

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

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

Other intangible assets

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

Note 4. Summary of significant accounting policies (continued)

4.5 Intangible assets (continued)

Subsequent expenditure

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

Amortization

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

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

4.6 Leased assets

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

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

4.7 Inventories

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

4.8 Impairment

Financial assets

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

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

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

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

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

Note 4. Summary of significant accounting policies (continued)

4.8 Impairment (continued)

Non-financial assets

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

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

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

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

4.9 Employee benefits

Defined contribution plans

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

Defined benefit plans and other long-term employee benefits

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

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

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

Note 4. Summary of significant accounting policies (continued)

4.10 Environmental liabilities

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

4.11 Non-current assets classified as held for sale

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

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

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

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

4.12 Revenue

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

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

4.13 Lease payments

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

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

4.14 Social expenditure

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

4.15 Finance income and expense

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

Note 4. Summary of significant accounting policies (continued)

4.15 Finance income and expense (continued)

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

4.16 Income tax expense

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

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

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

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

4.17 Dividends

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

4.18 Earnings per share

Basic earnings per share is determined by dividing the profit attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares in circulation during the reporting period, less the average number of treasury shares held by the Group.

4.19 Treasury shares

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

4.20 Segment reporting

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

Note 4. Summary of significant accounting policies (continued)

New Standards and Interpretations not yet adopted

A number of new Standards, amendments to Standards and Interpretations are not yet effective as at 31 December 2006, and have not been applied in preparing these consolidated financial statements. Of these pronouncements, potentially the following will have an impact on the Group's operations. The Group plans to adopt these pronouncements when they become effective.

- IFRS 7 *Financial Instruments: Disclosures and the Amendment to IAS 1 Presentation of Financial Statements: Capital Disclosures* require extensive disclosures about the significance of financial instruments for an entity's financial position and performance, and qualitative and quantitative disclosures on the nature and extent of risks. IFRS 7 and amended IAS 1, which become mandatory for the Group's 2007 financial statements, will require extensive additional disclosures with respect to Group's financial instruments and share capital.

- IFRS 8 *Operating Segments*, which is effective for annual periods beginning on or after 1 January 2009. The Standard introduces the "management approach" to segment reporting.

- IFRIC 8 *Scope of IFRS 2 Share-based Payment* addresses the accounting for share-based payment transactions in which some or all of goods or services received cannot be specifically identified. IFRIC 8 will become mandatory for the Group's 2007 financial statements, with retrospective application required.

- IFRIC 9 *Reassessment of Embedded Derivatives* requires that a reassessment of whether embedded derivative should be separated from the underlying host contract should be made only when there are changes to the contract. IFRIC 9 becomes mandatory for the Group's 2007 financial statements.

- IFRIC 10 *Interim Financial Reporting and Impairment* prohibits the reversal of an impairment loss recognised in a previous interim period in respect of goodwill, an investment in an equity instrument or a financial asset carried at cost. IFRIC 10 will become mandatory for the Group's 2007 financial statements, and will apply to goodwill, investments in equity instruments, and financial assets carried at cost prospectively from the date that the Group first applied the measurement criteria of IAS 36 and IAS 39 respectively (i.e. 1 January 2005).

- IFRIC 11 *IFRS 2 – Group and Treasury Share Transactions*, which is effective for annual periods beginning on or after 1 March 2007. The Interpretation addresses the classification of the share-based payment as equity-settled or cash-settled in the financial statements of the entity receiving the services.

- IFRIC 12 *Service Concession Arrangements*, which is effective for annual periods beginning on or after 1 January 2008. The Interpretation addresses how service concession operators should account for the obligations they undertake and rights they receive in service concession arrangements.

- IAS 23 *Borrowing costs*. The amendment is applied to borrowing costs, directly attributable to qualifying assets, which date of capitalization is annual periods beginning on or after 1 January 2009. The amendment excluded approach to recognize borrowing costs, directly attributable to qualifying assets, as expenses in the period in which it occurs.

- IFRIC 13 *Customer Loyalty Programmes*, which is effective for annual periods beginning on or after 1 July 2008. The Interpretation addresses the accounting for customer loyalty award credits by the grantor, including credit card providers.

- IFRIC 14 *IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements*, which is effective for annual periods beginning on or after 1 January 2008. The Interpretation addresses the defined benefit pension assets and their minimum funding requirements.

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

Note 5. Property, plant and equipment

	Electricity and heat generation	Heating networks	Construction-in-progress, including advances	Other	Total
Cost/Deemed cost					
Balance at 1 January 2005	28,536,704	6,435,141	537,169	140,713	35,649,727
Additions	-	-	1,791,488	370,538	2,162,026
Transfers	1,110,599	148,069	(1,260,133)	1,465	-
Balance at 31 December 2005	29,647,303	6,583,210	1,068,524	512,716	37,811,753
Balance at 1 January 2006	29,647,303	6,583,210	1,068,524	512,716	37,811,753
Additions	505,590	116,386	1,170,533	164,937	1,957,446
Transfers	937,908	310,363	(1,251,952)	3,681	-
Disposals	(12,129)	-	(4,887)	(8,982)	(25,998)
Balance at 31 December 2006	31 078 672	7 009 959	982 218	672 352	39 743 201
Depreciation					-
Balance at 1 January 2005	-	-	-	-	-
Depreciation for the year	(1,507,167)	(660,047)	-	(94,470)	(2,261,684)
Balance at 31 December 2005	(1,507,167)	(660,047)	-	(94,470)	(2,261,684)
Balance at 1 January 2006	(1,507,167)	(660,047)	-	(94,470)	(2,261,684)
Depreciation for the year	(1,683,992)	(711,357)	-	(79,746)	(2,475,095)
Disposals	3,115	-	-	3,455	6,570
Balance at 31 December 2006	(3,188,044)	(1,371,404)	-	(170,761)	(4,730,209)
Carrying amounts					
At 1 January 2005	28,536,704	6,435,141	537,169	140,713	35,649,727
At 31 December 2005	28,140,136	5,923,163	1,068,524	418,246	35,550,069
At 1 January 2006	28,140,136	5,923,163	1,068,524	418,246	35,550,069
At 31 December 2006	27,890,628	5,638,555	982,218	501,591	35,012,992

At 31 December 2006 construction in progress includes advance prepayments for property, plant and equipment of RR 72,996 thousand (2005: RR 29,856 thousand).

Determination of deemed cost

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

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

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

Note 5. Property, plant and equipment (continued)

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

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

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

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

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

Note 6. Intangible assets

Cost	**Computer software**	**Licenses**	**Development costs**	**Total**
Balance at 1 January 2005	-	-	-	-
Additions	172,233	162	22,735	195,130
Balance at 31 December 2005	172,233	162	22,735	195,130
Balance at 1 January 2006	172,233	162	22,735	195,130
Additions	109,252	604	295,529	405,385
Disposals	(90)	-	-	(90)
Balance at 31 December 2006	281,395	766	318,264	600,425
Amortisation				
Balance at 1 January 2005	-	-	-	-
Amortisation for the year	(2,786)	(12)	-	(2,798)
Balance at 31 December 2005	(2,786)	(12)	-	(2,798)
Balance at 1 January 2006	(2,786)	(12)	-	(2,798)
Amortisation for the year	(33,210)	(160)	(3,781)	(37,151)
Amortisation disposal in the year 2006	90	-	-	90
Balance at 31 December 2006	(35,906)	(172)	(3,781)	(39,859)
Carrying amounts				
At 1 January 2005	-	-	-	-
At 31 December 2005	169,447	150	22,735	192,332
At 1 January 2006	169,447	150	22,735	192,332
At 31 December 2006	245,489	594	314,483	560,566

Development costs represent the implementation of SAP software.

Note 7. Other non-current assets

	31 December 2006	31 December 2005
Restructured trade receivables (Note 10)	250,112	299,667
Trade and other receivables	145,432	143,775
Provision for impairment of accounts receivable	(47,902)	(47,902)
Advances for implementation of SAP software	110,158	11,914
Long-term VAT recoverable	66,762	77,180
Other	48,000	48,000
Total	**572,562**	**532,634**

Note 8. Available-for-sale financial assets

	31 December 2006	31 December 2005
Non-current investments		
Bank promissory notes	365,616	359,149
Total	**365,616**	**359,149**
Current investments		
Bank promissory notes	75,878	112,788
Total	**75,878**	**112,788**

The fair value of available-for-sale investments with a carrying amount of RR 398,630 thousand as at 31 December 2006 (2005: RR 359,829 thousand) was determined by using 8.7-9.4% (2005: 9.6-10.6%) discount rate and with reference to their maturity. The nominal value of these interest free promissory notes is RR 458,431 thousand.

Note 9. Cash

	31 December 2006	31 December 2005
Petty cash	79	155
Bank balances	967,117	340,647
Total	**967,196**	**340,802**

Note 10. Accounts receivable and prepayments

	31 December 2006	31 December 2005
Trade receivables	3,147,992	1,933,510
Advances to suppliers and prepayments	709,705	217,177
Tax prepayments	37,153	752
Other receivables	204,763	262,854
Provision for impairment of accounts receivable	(1,582,870)	(1,731,202)
Total	**2 ,516,743**	**683,091**

Certain trade receivables have been restructured and as a result are due to be realised more than one year from the balance sheet date (see Note 7). Expected future principle and interest cash flows from these receivables were discounted at 10.13%. The effect of discounting is included in net finance expenses (see Note 21).

Note 11. Inventories

	31 December 2006	31 December 2005
Fuel supplies	1,697,816	460,691
Raw materials and supplies	620,261	563,860
Spare parts	432,845	371,027
Other	8,178	9,390
Reserve for obsolescence	(65,455)	(27,024)
Total	**2,693,645**	**1,377,944**

At 31 December 2006 inventories with a carrying amount of RR 959,487 thousand (2005: Nil) where pledged as collateral for bank loans (see Note 14).

Note 12. Non-current assets held for-sale

	31 December 2006	31 December 2005
Shares		
OJSC Samaraenergospecremont	-	39,469
OJSC Samara industrial-repair enterprise	-	74,577
OJSC Saratov industrial-repair enterprise	-	55,000
OJSC Ulyanovskenergospecremont	-	8,000
OJSC Ulyanovsk industrial-repair enterprise	-	9,000
OJSC Orenburgenergoremont	-	59,906
Total	**-**	**245,952**

At 31 December 2005 non current assets held for sale comprised shares of subsidiaries, acquired within the framework of power systems restructuring. In April and July 2006 these shares were sold at their market value of RR 261,000 thousand. Gain from sales was included in the line "Other income" of the combined and consolidated income statement for the year ended 31 December 2006.

Note 13. Equity

	31 December 2006	31 December 2005
Ordinary shares	26,116,076,165	26,116,076,165
Par value (in RUR)	1.00	1.00

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

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

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

Both 2006 and 2005 years were presented as if restructuring completed in July 2007 had taken place at the beginning of the earliest period presented.

Note 14. Loans and finance lease liabilities

	31 December 2006	31 December 2005
Non-current		
Loan from related party	-	91,735
Finance lease liabilities	514	71
Total	**514**	**91,806**
Current		
Secured bank loans	1,630,400	30,000
Unsecured bank loans	1,253,550	442,445
Finance lease liabilities	1,102	554
Total	**2,885,052**	**472,999**

	Currency	Interest rate	Year of maturity	31 December 2006	31 December 2005
Secured bank loans	RUR	Mosprime+3%	2007	1,500,000	-
Secured bank loans	RUR	12%	2007	130,400	-
Secured bank loans	RUR	13%	2006	-	30,000
Unsecured bank loans	RUR	9.46%-9.72%	2007	1,200,000	-
Unsecured bank loans	RUR	12%	2007	50,000	-
Unsecured bank loans	RUR	13.2%	2006-2007	3,550	65,000
Unsecured bank loans	RUR	8.8%	2006	-	278,443
Unsecured bank loans	RUR	13%	2006	-	99,002
Total				**2,883,950**	**472,445**

The bank loans in the amount of RR 1,500,000 thousand are secured over inventories in the amount of RR 959,487 thousand (2005: Nil) (see Note 11).

The bank loans in the amount of RR 130,400 thousand (2005: RR 30,000 thousand) are secured by cash flows on certain power supply contracts.

Note 15. Promissory notes

	31 December 2006	31 December 2005
Non-current		
Long-term promissory notes	295,143	269,035
Current portion of long-term promissory notes	(74,363)	-
Total	**220,780**	**269,035**
Current		
Current portion of long-term promissory notes	74,363	-
Short-term promissory notes	54,445	47,940
Total	**128,808**	**47,940**

	31 December 2006	31 December 2005
Due for repayment		
Between one and two years	213,409	170,357
Between two and five years	7,371	98,678
Total	**220,780**	**269,035**

Promissory notes with the carrying value of RR 347,605 thousand as at 31 December 2006 (2005: RR 314,992 thousand) represent promissory notes issued by the Group in 2005 to OAO Mezhtopenergobank. The nominal value of these interest free promissory notes is RR 399,000 thousand. Expected future principle and interest cash flows were discounted at rates of between 9.1 and 10.6%. These rates were not materially different from current financing rate of the Group.

Note 16. Provisions for liabilities and charges

	Provision for holidays	Employee benefits
At 1 January 2006	10,145	1,101,112
Additional provision created	29,020	250,295
Provisions used	(10,145)	(66,757)
At 31 December 2006	**29,020**	**1,284,650**

Employee benefits

The Group has defined benefit pension and other long-term defined benefit plans that cover most full-time and retired employees. Defined post-employment benefits consist of several unfunded plans providing for lump-sum payments upon retirement, financial support for current pensioners, death benefits, jubilee benefits, old age life pension program. Management has assessed the net present value of these obligations, following the guidelines set out in IAS 19 *Employee Benefits*. Under this method an assessment has been made of an employee's service period with the Group, the expected salary and pension payable having regard to staff turnover statistics, retirement age, and salaries at retirement. The expected liabilities have been discounted to net present value using a rate of 6.75% per year. In view of the relative insignificance of the expense recognized in the combined and consolidated income statement for the year, the additional disclosures required by IAS 19 have not been made.

Note 17. Accounts payable and accrued charges

	31 December 2006	31 December 2005
Trade payables	737,342	656,869
Advances received	411,512	162,396
Wages and salary	300,899	37,991
Interest payable	5,299	-
Deferred income	1,176	817
Other payables	491,854	301,718
Total	**1,948,082**	**1,159,791**

Note 18. Other taxes payable

	31 December 2006	31 December 2005
Deferred VAT	803,838	889,476
Property tax	112,387	76,605
Value added tax	94,675	50,080
Employee taxes	92,909	5,221
Other taxes	120,077	6,281
Total	**1,223,886**	**1,027,663**

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

Note 19. Revenues

	Year ended 31 December 2006	Year ended 31 December 2005
Electricity	15,460,662	13,737,396
Heating	15,775,620	12,806,344
Other	3,064,318	2,621,396
Total	**34,300,600**	**29,165,136**

Note 20. Operating expenses

	Year ended 31 December 2006	Year ended 31 December 2005
Fuel	17,910,729	14,752,614
Third party services	3,201,922	3,588,807
Employee benefits	4,611,070	3,601,452
Depreciation	2,475,095	2,261,684
Material expenses	1,635,515	1,309,669
Taxes other than income tax	705,200	703,078
License fee	299,528	420,302
Purchased power	1,034,845	3,818
Provision for impairment of accounts receivable	(148,332)	287,686
Insurance	234,346	251,985
Bank services	158,109	119,921
Rental expenses	233,119	174,797
Water usage expenses	890,231	920,499
Amortization of intangible assets	37,151	2,798
Other expenses	719,873	914,803
Total	**33,998,401**	**29,313,913**

Employee benefits expenses comprise the following:

	Year ended 31 December 2006	Year ended 31 December 2005
Salaries and wages, benefits and payroll taxes	4,516,205	3,577,121
Non-governmental pension fund expenses	94,865	24,331
Employee benefits	**4,611,070**	**3,601,452**

Note 21. Net finance expense

	Year ended 31 December 2006	Year ended 31 December 2005
Interest income	11,118	13,151
Interest expense	(105,537)	(117,194)
Effect of discounting	(5,759)	106,197
Total	**(100,178)**	**2,154**

Note 22. Income tax expense

	Year ended 31 December 2006	Year ended 31 December 2005
Current income tax expense	715,437	475,638
Deferred income tax benefit	(534,728)	(444,314)
Total income tax expense	**180,709**	**31,324**

	Year ended 31 December 2006	Year ended 31 December 2005
Profit before income tax expense	324,936	159,994
Theoretical profit tax charge at an average statutory tax rate of 24%	77,985	38,399
Tax effect of items which are not deductible or taxable for taxation purposes	102,724	(7,075)
Total income tax expense	**180,709**	**31,324**

Note 22. Income tax expense (continued)

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

The temporary differences associated with undistributed earnings of subsidiaries amount to RR 38,849 thousand at 31 December 2006 (2005 – RR 30,890 thousand). A deferred tax liability on these temporary differences was not recognized because management controls the timing of the reversal of the temporary differences and they will not reverse in the foreseeable future.

Changes in deferred tax liabilities and assets within year 2005 are presented in the table below:

	1 January 2005	Recognized in profit and loss	31 December 2005
Deferred tax liabilities			
Property, plant and equipment	(6,349,923)	394,142	(5,955,781)
Promissory notes	-	(20,162)	(20,162)
Total deferred tax liabilities	**(6,349,923)**	**373,980**	**(5,975,943)**
Deferred tax assets			
Accounts receivable	434,298	63,194	497,492
Provisions	26,349	2,435	28,784
Other	-	4,705	4,705
Total deferred tax assets	**460,647**	**70,334**	**530 981**

Changes in deferred tax liabilities and assets within year 2006 are presented in the table below:

	1 January 2006	Recognized in profit and loss	31 December 2006
Deferred tax liabilities			
Property, plant and equipment	(5,955,781)	583,879	(5,371,902)
Promissory notes	(20,162)	7,827	(12,335)
Total deferred tax liabilities	**(5,975,943)**	**591,706**	**(5,384,237)**
Deferred tax assets			
Accounts receivable	497,492	(78,780)	418,712
Provisions	28,784	21,517	50,301
Other	4,705	285	4,990
Total deferred tax assets	**530,981**	**(56,978)**	**474,003**

Note 23. Earnings per share

	Year ended 31 December 2006	Year ended 31 December 2005
Weighted average number of ordinary shares issued (quantity) (See Note 13)	26,116,076,165	26,116,076,165
Net profit for the year	144,227	128,670
Earnings per ordinary share – basic (in Russian rubles)	0.0055	0.0049

Note 24. Related parties

The Group's related parties transactions are disclosed below:

Parent's subsidiaries

Transactions with the Parent's subsidiaries were as follows:

	Year ended 31 December 2006	Year ended 31 December 2005
Purchase of electricity	808,566	3,818
License fee	299,528	392,392
Rent expense	6	-

	31 December 2006	31 December 2005
Accounts receivable and prepayments	86,177	4,738
Accounts payable and accrued charges	107,354	137,918

State-controlled entities

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

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

	Year ended 31 December 2006	Year ended 31 December 2005
Electricity and heat sales	22,309,799	13,263,705
Purchase of gas	12,831,482	8,187,659
Interest income	14,201	-
Rent expense	44,241	-

	31 December 2006	31 December 2005
Accounts receivable and prepayments	732,897	1,158,687
Accounts payable and accrued charges	236,971	462,497

Tax balances are disclosed in the balance sheet and Notes 18 and 22. Tax transactions are disclosed in the income statement and Notes 20 and 22.

Compensations to the Board of Directors and key management

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

For the year 2006 the following compensations were made to the Management Board and Board of Directors:

	Year ended 31 December 2006	Year ended 31 December 2005
Wages, salaries and bonuses	46,149	4,423
Total	**46,149**	**4,423**

Note 25. Operating leases

Operating leases payable

Operating lease rentals are payable as follows:

	31 December 2006	31 December 2005
Less than one year	37,058	92,822
Between one and five years	21,419	53,523
Total	**58,477**	**146,345**

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

Operating leases receivable

Operating lease rentals are receivable as follows:

	31 December 2006	31 December 2005
Less than one year	62,815	82,595
Between one and five years	46,179	64,671
More than five years	1,450	31
Total	**110,444**	**147,297**

Note 26. Commitments

Purchase commitments

The Group has a number of outstanding contracts to purchase natural gas. The quantity of natural gas to be supplied is annually allocated by RAO UES of Russia in coordination with OJSC GAZPROM given the capacity of utilization of alternative fuel and the required fuel reserve fixed by RAO UES of Russia. The purchase price of gas is fixed by the Federal Service of Tariffs. In the year 2007 the evaluated volume of supplies under the current contracts will be approximately equal to RR 12,359,407 thousand.

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

Capital commitments

In the normal course of business, the Group has outstanding commitments under the contracts for the purchase and construction of property, plant and equipment for RR 760,966 thousand.

Note 27. Contingencies

Insurance

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

Legal proceedings

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

Note 27. Contingencies (continued)

Taxation

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

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

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

Environmental matters

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

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

Note 28. Financial instruments

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

Credit risk

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

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

Foreign exchange risk

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

Interest rate risk

Changes in interest rates impact primarily loans and borrowings by changing either their fair value (fixed rate debt) or their future cash flows (variable rate debt). Management does not have a formal policy of determining how much of the Group's exposure should be to fixed or variable rates. However, at the time of raising new loans or borrowings management uses its judgment to decide whether it believes that a fixed or variable rate would be more favourable to the Group over the expected period until maturity. Interest rates are disclosed in Note 14.

Note 28. Financial instruments (continued)

Fair values

The fair value of available for sale financial assets, restructured trade receivables and promissory notes is discussed in Note 8, Note 10 and Note 15, respectively. Management believes that the fair value of other financial assets and financial liabilities is not significantly different from their carrying amounts.

Note 29. Events after the balance sheet date

The Annual General Meeting of the shareholders on 29 May 2007 approved dividends on ordinary shares in respect of the year ended 31 December 2006 in the amount of 0.0030878 Russian rubles per share for the total of RR 78,800 thousand.