# Interregional Distribution Grid (IDG) Company of North-West

**Consolidated financial statements**
for the years ended December 31, 2008 and 2007

## Contents

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# Independent Auditors' Report

To the Board of Directors of Open Joint Stock Company
Interregional Distribution Grid Company of North-West

## Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Open Joint Stock Company Interregional Distribution Grid Company of North-West (the "Company") and its subsidiaries (the "Group"), which comprise the consolidated balance sheets as at 31 December 2007 and 2008, and the consolidated income statements, consolidated statements of changes in equity 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 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 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.

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 RUR 582,836 thousand as at 31 December 2007 because we were engaged as auditors of the Group only after that date. 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 inventories, operating expenses, taxation expense, net profit and retained earnings as at and for the year ended 31 December 2007, and to operating expenses, taxation expense and net profit for the year ended 31 December 2008.

*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 consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2007 and 2008, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards.

ZAO KPMG

ZAO KPMG
15 July 2009

## IDGC OF NORTH-WEST

### CONSOLIDATED INCOME STATEMENT
### FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007
*(In thousands of RUR, except share and per share data)*

| | Notes | 2008 | 2007 |
|---|---|---|---|
| **Revenue:** | | | |
| Power transmitting | | 18,253,551 | 16,405,813 |
| Connection to power network | | 768,994 | 614,706 |
| Sale of electricity | | 3,317,864 | 2,878,450 |
| Other revenue | | 908,138 | 1,380,731 |
| **Total revenue** | | **23,248,547** | **21,279,700** |
| Government subsidies received | | 146,177 | 114,000 |
| **Expenses:** | | | |
| Electric power to cover losses | | (2,853,504) | (2,512,943) |
| Electric purchases for resale | | (1,620,843) | (1,247,582) |
| Raw materials | | (1,220,904) | (1,171,787) |
| Salaries and other personnel expenses | 7 | (5,512,231) | (5,737,762) |
| Depreciation and amortization of non-current assets | | (2,168,306) | (1,878,922) |
| Power transmitting services | | (5,625,329) | (4,266,524) |
| Network and equipment repair services | | (802,408) | (693,930) |
| Other industrial services | | (604,520) | (571,581) |
| Other services | | (1,197,633) | (1,319,166) |
| Taxes other than income tax | | (156,428) | (197,026) |
| Other operating expenses | | (272,065) | (502,403) |
| **Operating result** | | **1,360,553** | **1,294,074** |
| Other non-operating income/(expense), net | | 4,342 | 124,295 |
| Financial costs, net | 8 | (114,568) | (73,870) |
| **Profit before income tax** | | **1,250,327** | **1,344,499** |
| **Income tax expense** | 9 | **(175,259)** | **(508,779)** |
| **Net profit for the year** | | **1,075,068** | **835,720** |
| **Attributable to:** | | | |
| Equity holders of the parent | | 996,909 | 508,933 |
| Non-controlling interest | | 78,159 | 326,787 |
| **Earnings per share based on weighted average number of ordinary shares in issue from the date of reorganization to the end of reporting period** | | | |
| Basic and diluted earnings per share (expressed in RUR) | | 0.0104 | 0.0053 |
| Weighted average number of ordinary shares in issue from the date of reorganization | | 95,785,923,138 | 95,785,923,138 |

These consolidated financial statements were approved by management of the Group on 15 July 2009 and were signed on its behalf by:

Deputy General Director - Chief Engineer Turlov G. V.

Deputy General Director for economy and finances Makarova O. V.

Chief Accountant Maksimova T. V.



The consolidated income statement is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements set out on pages 10 to 48.

## IDGC OF NORTH-WEST

### CONSOLIDATED BALANCE SHEET
### AT DECEMBER 31, 2008 AND 2007
*(In thousands of RUR)*

| | Notes | 2008 | 2007 |
|---|---|---|---|
| **ASSETS** | | | |
| **Non-current assets** | | | |
| Property, plant and equipment | 10 | 26,856,049 | 24,704,482 |
| Intangible assets | 11 | 136,208 | 133,880 |
| Deferred tax assets | 9 | 569 | 3,765 |
| Investment in securities and other financial assets | 12 | 106,012 | 177,563 |
| Other non-current assets | | 9,305 | 62,607 |
| **Total non-current assets** | | **27,108,143** | **25,082,297** |
| **Current assets** | | | |
| Accounts receivable | 13 | 3,070,076 | 1,088,996 |
| Income tax receivable | | 63,573 | 90,753 |
| Prepayments | | 167,304 | 373,248 |
| Inventories | 14 | 747,331 | 582,836 |
| Cash and cash equivalents | 15 | 718,662 | 681,539 |
| Other current assets | | 201,781 | 220,612 |
| Assets classified as held for sale | 5 | - | 138,669 |
| **Total current assets** | | **4,968,727** | **3,176,653** |
| **Total assets** | | **32,076,870** | **28,258,950** |
| **EQUITY AND LIABILITIES** | | | |
| **Capital and reserves** | | | |
| Shareholders' capital | | 9,578,592 | 10,000 |
| Retained earnings | | 922,571 | (5,526) |
| Merge reserve | | 10,439,687 | 11,585,668 |
| **Equity attributable to the equity holders of the parent** | | **20,940,850** | **11,590,142** |
| Non – controlling interest | | 322 | 8,275,962 |
| **Total equity** | 16 | **20,941,172** | **19,866,104** |
| **Non-current liabilities** | | | |
| Long-term loans and borrowings | 17 | 1,568,189 | 353,052 |
| Long-term obligations under finance leases | 18 | 49,814 | 102,526 |
| Retirement benefit obligations | 19 | 1,008,907 | 1,280,696 |
| Deferred tax liabilities | 9 | 1,865,358 | 1,912,454 |
| Other non-current liabilities | | 91,753 | - |
| **Total non-current liabilities** | | **4,584,021** | **3,648,728** |
| **Current liabilities** | | | |
| Accounts payable and advances received | 20 | 2,973,762 | 2,404,093 |
| Current obligations under finance leases | 18 | 53,556 | 126,634 |
| Current taxes payable | | 275,031 | 448,914 |
| Income tax payable | | 79,356 | 71,400 |
| Current loans and borrowings | 17 | 3,132,998 | 1,352,452 |
| Current provisions | 21 | 36,974 | 234,584 |
| Liabilities directly associated with assets classified as held for sale | 5 | - | 106,041 |
| **Total current liabilities** | | **6,551,677** | **4,744,118** |
| **Total liabilities** | | **11,135,698** | **8,392,846** |
| **Total equity and liabilities** | | **32,076,870** | **28,258,950** |



The consolidated balance sheet is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements set out on pages 10 to 48.

## IDGC OF NORTH-WEST

### CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
### FOR THE YEAR ENDED DECEMBER 31, 2008 AND 2007
***(In thousands of RUR)***

| | Attributable to equity holders of the parent | | | | | |
|---|---|---|---|---|---|---|
| | **Share capital** | **Retained earnings** | **Merger reserve** | **Total equity of parent's shareholders** | **Non – controlling interest** | **Total** |
| **Balance at January 1, 2007** | **10,000** | **(2,903)** | **11,185,271** | **11,192,368** | **8,019,104** | **19,211,472** |
| Profit for the year | - | (2,623) | 511,556 | 508,933 | 326,787 | 835,720 |
| Payment of dividends | - | - | (111,159) | (111,159) | (69,929) | (181,088) |
| **Balance at December 31, 2007** | **10,000** | **(5,526)** | **11,585,668** | **11,590,142** | **8,275,962** | **19,866,104** |
| Profit for the year | - | 928,097 | 68,812 | 996,909 | 78,159 | 1,075,068 |
| Change in equity due to the Group's reorganisation | 9,568,592 | - | (1,214,793) | 8,353,799 | (8,353,799) | - |
| **Balance at December 31, 2008** | **9,578,592** | **922,571** | **10,439,687** | **20,940,850** | **322** | **20,941,172** |



The consolidated statement of changes in equity is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements set out on pages 10 to 48.

## IDGC OF NORTH-WEST

### CONSOLIDATED STATEMENT OF CASH FLOWS
### FOR THE YEAR ENDED DECEMBER 31, 2008 AND 2007
***(In thousands of RUR)***

| | 2008 | 2007 |
|---|---|---|
| **Operating activities** | | |
| **Profit for the year** | **1,075,068** | **835,720** |
| **Adjustments for non-cash transactions:** | | |
| Income tax expense recognised in profit or loss | 175,259 | 508,779 |
| Net finance cost | 114,568 | 73,870 |
| Depreciation and amortisation of non-current assets | 2,168,306 | 1,878,922 |
| Bad debt provisions recognised on accounts receivables | 51,515 | 37,705 |
| Tax remitted by tax authorities | - | (198,938) |
| Loss from disposal of PPE | 31,978 | 58,164 |
| Gain from disposal of subsidiaries | (65,273) | (109,386) |
| Other non-cash (gains)/losses | 6,326 | (31,301) |
| | **3,557,747** | **3,053,535** |
| **Movements in working capital** | | |
| (Increase)/decrease in accounts receivable and prepayments | (1,830,456) | 411,932 |
| Increase in inventories | (101,992) | (2,888) |
| Decrease/(increase) in other current assets | 82,697 | (107,152) |
| Change in retirement benefit obligation | (271,240) | 90,485 |
| (Decrease)/increase in current accounts payable, advances received and provisions | (131,178) | 404,492 |
| **Cash generated by operations** | **1,305,578** | **3,850,404** |
| Interest paid | (329,638) | (149,413) |
| Income tax paid | (184,023) | (439,884) |
| **Net cash generated by operating activities** | **791,917** | **3,261,107** |
| **Investing activities** | | |
| Proceeds from disposal of property, plant and equipment | 91,280 | 133,165 |
| Proceeds from disposal of subsidiaries | 34,030 | 177,796 |
| Purchase of property, plant and equipment and other non-current assets | (3,751,774) | (3,491,933) |
| Interest received | 4,791 | 5,102 |
| **Net cash used in investing activities** | **(3,621,673)** | **(3,175,870)** |



The consolidated statement of cash flows is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements set out on pages 10 to 48.

# IDGC OF NORTH-WEST

## CONSOLIDATED CASH FLOW STATEMENT
## FOR THE YEAR ENDED DECEMBER 31, 2008 AND 2007 (CONTINUED)
***(In thousands of RUR)***

| | 2008 | 2007 |
|---|---|---|
| **Financing activities** | | |
| Proceeds from loans and borrowings | 8,910,280 | 10,140,622 |
| Repayments of loans and borrowings | (5,912,649) | (9,572,711) |
| Repayments of finance leases | (125,792) | (235,005) |
| Dividends paid | (4,960) | (181,915) |
| **Net cash generated by financing activities** | **2,866,879** | **150,991** |
| **Net increase in cash and cash equivalents** | **37,123** | **236,228** |
| **Cash and cash equivalents at the beginning of the year** | **681,539** | **445,311** |
| **Cash and cash equivalents at the end of the year** | **718,662** | **681,539** |



The consolidated statement of cash flows is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements set out on pages 10 to 48.

## 1. THE GROUP AND ITS OPERATIONS

### Background

Open Joint Stock Company Interregional Distribution Grid Company of North-West (IDGC of North-West or the Company) was established in December 2004 in accordance with the laws of the Russian Federation. The Company was formed in the process of re-organization of JSC "RAO UES of Russia" (RAO UES) as the owner and operator of the electric power transmission and distribution grid in the North-West Region of Russia.

The registered office of the Company is located at Sobornaya str. 31, Gatchina, Leningradskaya oblast, 188300, the Russian Federation. The Company's main offices are located at Tyushina st. 11, building "G", Saint Petersburg, 191119, the Russian Federation.

### Formation of the Group

On April 27, 2007 the Board of Directors of RAO UES approved the structure of Interregional Distribution Grid Companies. Under the approved structure, the IDGC Group (the Group) incorporated IDGC of North-West with seven branches, located in Arkhangelsk, Vologda, Siktivkar, Novgorod, Pskov, Petrozavodsk and Murmansk and subsidiaries. The principal subsidiaries are listed in Note 4.

The branches were formed on the basis of seven Regional Distribution Grid Companies: JSC "Arkhenergo", JSC "Vologdaenergo", JSC "AEK Komienergo", JSC "Novgorodenergo", JSC "Pskovenergo", JSC "Karelenergo", JSC "Kolenergo", all of which were subsidiaries of RAO UES prior to the formation of the Group. The merger was a business combination among entities under common control, and has been accounted for using the predecessor accounting method (see Note 2).

On July 1, 2008 RAO UES ceased to exist as a separate legal entity and transferred its 55.4% of the Company's shares to JSC IDGC Holding, a state-controlled entity.

### Relations with the state and current regulations

The Group business is the natural monopoly which is under pressure and support of Russian government. The government of the Russian Federation directly affects the Group's operations through the state tariffs.

In accordance with legislation the Group's tariffs are controlled by the Federal Service on Tariffs, the Regional Energy Comission.

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

### Recent volatility in the financial markets and the Group's financial position

In recent months a number of major economies around the world have experienced volatile capital and credit markets. A number of major global financial institutions have been placed into bankruptcy, taken over by other financial institutions and/or supported by government funding. As a consequence of the recent market turmoil in capital and credit markets both globally and in Russia, notwithstanding any potential economic stabilisation measures that may be put into place by the Russian Government, there exists as at the date these consolidated financial statements are authorised for issue economic uncertainties surrounding the continual availability, and cost, of credit both for the Group and its counterparties, the potential for economic uncertainties to continue in the foreseeable future and, as a consequence, the potential that assets may be not be recovered at their carrying amount in the ordinary course of business, and a corresponding impact on the Group's profitability.

As of December 31, 2008 the Group's current liabilities exceeded its current assets by RUR 1,582,950 thousand (2007: RUR 1,567,465 thousand). Management efforts to improve Group's liquidity position concentrate primarily on increasing operating cash flows through increases of sales revenues and improving margins by cost reduction programs, and refinancing of the existing liabilities. Management believes that the Group's available borrowing facilities and operating cash flows will be sufficient to fund its operations for the next year.

## 2. BASIS OF PREPARATION

### Statement of compliance

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS").

### IFRS first time application

These consolidated financial statements are the first full set of consolidated financial statement, prepared in accordance with IFRS. In accordance with reporting regulations of Russian Federation, the Group has not previously prepared consolidated financial statements.

The accounting policies set out in Note 3 have been applied in preparing the financial statements for the years ended 31 December 2008 and 2007 and in the preparation of an opening IFRS statement of financial position at 1 January 2007 (the Group's date of transition). In preparing these consolidated financial statements the Group used IFRS, effective as at December 31, 2008 and used them consistently in preparation of these consolidated financial statements.

In preparing its opening IFRS balance sheet, the Group has adjusted amounts reported previously in its financial statements prepared in accordance with russian accounting principles.

The Group uses exceptions from IFRS for the first-time adopter of IFRS for the business combinations recognized before the date of transition to IFRS, and for revalued amount of property plant and equipment as deemed historic cost.

### Basis of preparation

The consolidated preliminary IFRS financial statements are prepared on the historical cost basis except for the derivative financial instruments, investments at fair value through profit or loss and investments available-for-sale that are stated at fair value; property, plant and equipment was revalued as of January 1, 2007 by an independent appraiser to determine deemed cost as part of the adoption of IFRSs (see Note 10).

The Group companies maintain their accounting records in Russian Roubles ("RUR") in accordance with the accounting and reporting regulations of the Russian Federation. Russian statutory accounting principles and procedures differ substantially from those generally accepted under IFRS. Accordingly, the consolidated financial statements, which have been prepared using the Group's statutory accounting records, reflect adjustments necessary for such financial statements to be presented in accordance with IFRS.

**Functional and presentation currency**

The national currency of the Russian Federation is the Russian Rouble (“RUR”), which is the Group functional currency and the currency in which these financial statements are presented. All financial information presented in RUR has been rounded to the nearest thousand.

**Predecessor accounting**

In these consolidated financial statements for the year ended December 31, 2008 the Group accounted for the merger with entities controlled by RAO UES as business combination among entities under common control in accordance with its accounting policy using the predecessor values method. Accordingly, assets and liabilities of the contributed entities were accounted for at carrying value. The difference between the consideration paid and the predecessor carrying values of the net assets relating to the merger of the entities under common control is recorded in equity as a merger reserve.

Information in respect of the comparative period in the opening balance as of January 1, 2007 has been restated as if the business combination took place at the beginning of the earliest period presented. Therefore JSC “Arkhenergo”, JSC “Vologdaenergo”, JSC “Karelenergo”, JSC “Kolenergo”, JSC “AEK Komienergo”, JSC “Novgorodenergo” and JSC “Pskovenergo” were accounted in the Group’s consolidated financial statements effective from January 1, 2007.

Minority interest of the Group includes the proportional shares of JSC “Arkhenergo” (41%), JSC “Vologdaenergo” (51%), JSC “Kolenergo” (34.5%), JSC “AEK Komienergo” (49.7%), JSC “Novgorodenergo” (37.2%) and JSC “Pskovenergo” (51%) minority shareholders of their equity and results of operations up to the date of the merger.

As of April 1, 2008 the previously separate regional entities under common control were merged into IDGC of North-West (see Note 1). Accordingly, the comparative information for the year ended December 31, 2007 included as part of these consolidated financial statements is presented as if this merger was made as of January 1, 2007.

**Use of estimates**

In the application of the Group’s accounting policies, which are described in Note 3 below, management is required to make judgments, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

In particular, information about significant areas of estimation uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements is included in the following areas.

***Trade and other receivables***

Accounts receivable are stated at their net realisable value after deducting an allowance for doubtful accounts. The allowance for doubtful accounts is the Group's best estimate of probable credit losses in the Group's existing accounts receivable balances. In estimating the allowance, management considers a number of factors including current overall economic conditions, industry-specific economic conditions and historical and anticipated customer performance. Uncertainties regarding changes in the financial condition of customers, either adverse or positive, could impact the amount and timing of any additional allowances for doubtful accounts that may be required.

***Useful economic life and residual value of property, plant and equipment***

The estimated useful lives are based on management's business plans and operational estimates, related to assets.

The factors that could affect the estimation on non-current assets' life and its residual value include the following:

- Changes in asset utilization rates;
- Changes in maintenance technology;
- Changes in regulations and legislation; and
- Unforeseen operational issues.

Any of the above could affect prospective depreciation of property, plant and equipment and their carrying and residual values.

Management periodically reviews the appropriateness of assets' useful economic lives. The review is based on the current condition of the assets and the estimated period during which they will continue to bring economic benefit to the Group.

***Impairment of assets***

The Group periodically evaluates the recoverability of the carrying amount of its assets. Whenever events or changes in circumstances indicate that the carrying amounts of those assets may not be recoverable, the Group estimates the recoverable amount of the asset. This requires the Group to make judgments regarding long-term forecasts of future revenues and costs related to the assets subject to review. In turn, these forecasts are uncertain in that they require assumptions about demand for products and future market conditions. Significant and unanticipated changes to these assumptions and estimates included within the impairment reviews could result in significantly different results than those recorded in the consolidated financial statements.

***Taxation***

The Group is subject to income tax and other taxes in Russian Federation. Significant judgement is required in determining the provision for income tax and other taxes due to the complexity of the tax legislation of the Russian Federation. There are many transactions and calculations for which the ultimate tax determination is uncertain. The Group recognises liabilities for anticipated tax inspection issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the amount of tax and tax provisions in the period in which such determination is made.

In addition, the Group records deferred tax assets at each balance sheet date based on the amount that management believes will be utilised in future periods. This determination is based on estimates of future profitability. A change in these estimates could result in the write off of deferred tax assets in future periods for assets that are currently recorded on the consolidated balance sheet. In estimating levels of future profitability, the Group has considered historical results of operations in recent years and would, if necessary, consider the implementation of prudent and feasible tax planning strategies to generate future profitability. If future profitability is less than the amount that has been assumed in determining the deferred tax asset, then an increase in valuation reserve will be required, with a corresponding charge against income. On the other hand, if future profitability exceeds the level that has been assumed in calculating the deferred tax asset, the valuation reserve could be reduced, with a corresponding credit to income.

***Provisions***

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that the Group will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the balance sheet date, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, the receivable is recognised as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

Present obligations arising under onerous contracts are recognised and measured as a provision. An onerous contract is considered to exist where the Group has a contract under which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.

***Allowance for slow-moving inventory***

The Group creates an allowance for obsolete and slow-moving raw materials. Estimates of net realisable value of inventories are based on the most reliable evidence available at the time the estimates made. These estimates take into consideration fluctuations of prices or costs directly relating to events occurring subsequent to the balance sheet date to the extent that such events confirm conditions existing at the end of the reporting period. Changes in the supply and demand for the products, any subsequent changes to prices or costs may require adjustments to the estimated allowance for obsolete and slow-moving raw materials.

## 3. SIGNIFICANT ACCOUNTING POLICIES

### Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities (including special purpose entities) controlled by the Group (its subsidiaries). Control is achieved where the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate. Where necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with those used by other members of the Group. All intra-group transactions, balances, income and expenses are eliminated in full on consolidation.

Minority interests in the net assets (excluding goodwill) of consolidated subsidiaries are identified separately from the Group’s equity therein. Minority interests consist of the amount of those interests at the date of the original business combination (see below) and the minority’s share of changes in equity since the date of the combination. Losses applicable to the minority in excess of the minority’s interest in the subsidiary’s equity are allocated against the interests of the Group except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses.

**Foreign currencies**

In preparing the financial statements of the individual entities, transactions in currencies other than the entity’s functional currency (foreign currencies) are recorded at the rates of exchange prevailing at the dates of the transactions. At each balance sheet date, monetary items denominated in foreign currencies are retranslated at the rates prevailing at the balance sheet date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing at the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences are recognised in profit or loss in the period in which they arise except for exchange differences which relate to assets under construction for future productive use, which are included in the cost of those assets when they are regarded as an adjustment to interest costs on foreign currency borrowings.

**Property, plant and equipment**

***Owned assets***

Items of property, plant and equipment, except for land, are measured at historical cost (or deemed cost) less accumulated depreciation and impairment loss. Land is measured at cost less accumulated impairment loss. The deemed cost of property, plant and equipment of the branches, which were merged into the Group, was determined by reference to its fair value as of January 1, 2007, the date of transition to IFRS (see Note 10).

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.

Gains and losses on disposal of an item of property, plant and equipment are recognised net in “other gains and losses” in the income statement.

***Subsequent expenditure***

Expenditure incurred to replace a component of an item of property, plant and equipment that is accounted for separately is capitalised with the carrying amount of the component being written off. Other subsequent expenditure is capitalised if future economic benefit will arise from the expenditure. All other expenditure, including repairs and maintenance expenditure, is recognised in the income statement as an expense as incurred.

***Leased assets***

Leases in terms of which the Group assumes substantially all the risks and rewards of ownership are classified as finance leases. Plant and equipment acquired by way of finance lease is stated at an amount equal to the lower of its fair value and the present value of the minimum lease payment at inception of the lease less accumulated depreciation and impairment losses.

The corresponding liability to the lessor is included in the balance sheet as a finance lease obligation.

Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly to profit or loss, unless they are directly attributable to qualifying assets, in which case they are capitalized.

***Depreciation***

Depreciation is charged to the income statement on a straight-line basis over the estimated useful lives of the individual assets. Depreciation commences on the date when an asset is ready for its intended use. Land is not depreciated.

The estimated useful lives are as follows:

- Buildings and structures 7-50 years;
- Power conversion equipment 5-29 years;
- Power transmission equipment 7-33 years;
- Other 2-30 years.

The depreciation policy for depreciable leased assets is consistent with that for depreciable assets that are owned. If there is no reasonable certainty that the lessee will obtain ownership by the end of the lease term, the asset shall be fully depreciated over the shorter of the lease term and its useful life.

**Intangible assets**

All of the Group's intangible assets have finite useful lives and are capitalised on the basis of the costs incurred to acquire and prepare for their intended use. Intangible assets are amortised using the straight-line method from the date they are ready for use over their useful lives as follows:

- Software 3-15 years;
- Licenses and certificates 3- 5 years.

**Non-current assets held for sale**

Non-current assets and disposal groups are classified as held for sale if their carrying amount will be recovered principally through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset (or disposal group) is available for immediate sale in its present condition. Management must be committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of classification.

Immediately before classification as held for sale, the assets (or components of a disposal group) are remeasured in accordance with the Group's accounting policies. Thereafter generally the assets (or disposal group) are measured at the lower of their carrying amount and fair value less cost 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 and investment property, which continue to be measured in accordance with the Group's accounting policies. Impairment losses on initial classification as held for sale and subsequent gains and losses on remeasurement are recognised in income statement. Gains are not recognised in excess of any cumulative impairment loss.

**Financial assets**

The Group classifies its financial assets in the following categories: financial assets at fair value through profit or loss (FVTPL), loans and accounts receivable, held-to-maturity and available-for-sale. The classification depends on the purpose for which the financial assets are aquired. Management determines the classification of its financial assets at initial recognition.

***Held to maturity financial assets***

Held to maturity financial assets are financial assets with fixed or determinable payments and fixed maturity that the Group has the positive intent and ability to hold to maturity other than loans and accounts receivable originated by the Group. Held to maturity financial assets are recorded at amortised cost using the effective interest rate method less any impairment loss.

The effective interest method is a method of calculating the amortised cost of a financial asset and oпf allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset, or, where appropriate, a shorter period.

Income is recognised on an effective interest rate basis for debt instruments other than those financial assets designated as at FVTPL.

***Available for sale financial assets***

Available for sale financial assets are non-derivatives that are either designated in this category or not classified in any of the categories. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the balance sheet date. Available-for-sale financial assets mainly include investments in listed and unlisted shares. Listed shares held by the Group that are traded in an active market are stated at their market value. Gains and losses arising from changes in fair value are recognised directly in equity in the investment revaluation reserve with the exception of impairment losses, interest calculated using the effective interest rate method and foreign exchange gains and losses on monetary assets, which are recognised directly in the consolidated income statement. Where an investment is disposed of or is determined to be impaired, the cumulative gain or loss previously recognised in the investment revaluation reserve is included in the consolidated income statement for the period. Dividends on available-for-sale equity instruments are recognized in the consolidated income statement when the Group's right to receive the dividends is established. Investment in unlisted shares that do not have a quoted market price in an active market and whose fair value can not be readily measured are recorded at cost.

***Financial assets at fair value through profit or loss***

An instrument is classified 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 in accordance with the Group's documented risk management or investment strategy. 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.

***Loans and receivables***

Trade and other receivables that have fixed or determinable payments that are not quoted in an active market are classified as receivables. They are measured at amortised cost using the effective interest method, less any impairment. Interest income is recognised by applying the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial.

***Impairment of financial assets***

Financial assets, other than those as at FVTPL, are assessed for indicators of impairment at each balance sheet date. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been impacted.

For financial assets carried at amortised cost, the amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of receivables, where the carrying amount is reduced through the use of an allowance account. When a trade receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognised in profit or loss.

If in a subsequent period the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

***Derecognition of financial assets***

The Group derecognises a financial asset only when the contractual rights to the cash flows from the asset expire; or it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If the Group neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Group recognises its retained interest in the asset and an associated liability for amounts it may have to pay. If the Group retains substantially all the risks and rewards of ownership of a transferred financial asset, the Group continues to recognise the financial asset and also recognises a collateralised borrowing for the proceeds received.

**Spare parts**

Spare parts and servicing equipment are carried as inventory and recognized in profit or loss as consumed. However, major spare parts and stand-by equipment qualify as property, plant and equipment when an entity expects to use them during more than one period. Similarly, if the spare parts and servicing equipment can be used only in connection with an item of property, plant and equipment, they are accounted for as property, plant and equipment.

**Inventories**

Inventories are stated at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses. The cost of inventories is calculated on the weighted average basis or using the specific identification method and includes expenditure incurred in acquiring the inventories and bringing them to their existing location and condition.

**Cash and cash equivalents**

Cash and cash equivalents comprise cash balances and cash deposits and highly liquid investments with maturities of three months or less, those are readily convertible to known amount of cash and are subject to an insignificant risk of change in value. Bank overdrafts that are repayable on demand and form an integral part of the Group’s cash management are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

**Impairment**

The carrying amounts of the Group’s tangible and intangible assets are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the assets’ recoverable amounts are estimated.

The recoverable amount of assets is the greater of their fair value less costs to sell and value in use. 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. For an asset that does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

An impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in the income statement.

An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is only reversed 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.

**Dividends**

Dividends are recognised as a liability and deducted from equity at the balance sheet date only if they are declared (approved by the 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.

**Financial liabilities**

Financial liabilities, including loans and borrowings, trade and other payables, are initially measured at fair value, net of transaction costs.

Financial liabilities are subsequently measured at amortised cost using the effective interest method, with interest expense recognised on an effective yield basis.

The Group derecognises financial liabilities when, and only when, the Group’s obligations are discharged, cancelled or they expire.

**Retirement benefit obligations**

In the normal course of business the Group contributes to the Russian Federation defined contribution state pension scheme on behalf of its employees. Mandatory contributions to the governmental pension scheme are expensed when incurred.

The Group has also operated a combination of defined benefit and defined contribution plans until December 2007, in respect of which it had contracts with a non-governmental pension fund. The Board of Directors at their meeting of December 28, 2007 has taken the decision to curtail the defined benefit part of the plan which affected the liability recognised in the balance sheet.

Contributions to defined contribution retirement benefit plans are recognised as an expense when employees have rendered service entitling them to the contributions.

For defined benefit retirement benefit plans, the cost of providing benefits is determined using the Projected Unit Credit Method, with actuarial valuations being carried out at each balance sheet date. Actuarial gains and losses that exceed 10 per cent of the greater of the present value of the Group’s defined benefit obligation and the fair value of plan assets as at the end of the prior year are amortised over the expected average remaining working lives of the participating employees. Past service cost is recognised immediately to the extent that the benefits are already vested, and otherwise is amortised on a straight-line basis over the average period until the benefits become vested.

The retirement benefit obligation recognised in the balance sheet represents the present value of the defined benefit obligation as adjusted for unrecognised actuarial gains and losses and unrecognised past service cost, and as reduced by the fair value of plan assets. Any asset resulting from this calculation is limited to unrecognised actuarial losses and past service cost, plus the present value of available refunds and reductions in future contributions to the plan.

**Provisions**

Provisions are recognized when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that the Group will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. The amount recognized as a provision is the best estimate of the consideration required to settle the present obligation at the balance sheet date, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows. When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, the receivable is recognized as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

**Revenue recognition**

Revenue is measured at the fair value of the consideration received or receivable. Revenues are shown net of value added tax (VAT).

***Rendering of services***

The revenue from the transmitting of electricity is recognised on the straight-line basis in the period the service was rendered based on the actual amount of service provided, determined based on the measurements of supply meter.

The revenue for the connection to the power network is recognised in the full amount at the moment actual connection of the customer to the network.

***Dividend and interest revenue***

Dividend revenue from investments is recognised when the shareholder's right to receive payment has been established.

Interest revenue is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

***Government grants***

Grants that compensate the Group for expenses incurred are recognised in profit or loss on a systematic basis in the same periods in which the expenses are recognised.

**Borrowing costs**

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale. Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalisation. All other borrowing costs are recognised in profit or loss in the period in which they are incurred.

**Income Tax**

Income tax expense represents the sum of the tax currently payable and deferred tax.

***Current tax***

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the consolidated income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

***Deferred tax***

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences, and deferred tax assets are generally recognised for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences associated with investments in subsidiaries and associates, and interests in joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments and interests are only recognised to the extent that it is probable that there will be sufficient taxable profits against which to utilise the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realised, based on tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Group expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities on a net basis.

Current and deferred tax are recognised as an expense or income in profit or loss, except when they relate to items credited or debited directly to equity, in which case the tax is also recognised directly in equity, or where they arise from the initial accounting for a business combination. In the case of a business combination, the tax effect is taken into account in calculating goodwill or in determining the excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost of the business combination.

**Segment reporting**

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), that is subject to risks and rewards that are different from those of other segments. The Group's primary format for segment reporting is based on geographical segments. The geographical segments are determined based on the Group's management and internal reporting structure. The secondary segments are business segments.

Segment results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items comprise mainly loans and borrowings and related expenses, corporate assets (primarily the Company's headquarters) and head office expenses, and income tax assets and liabilities.

Segment capital expenditure is the cost incurred during the period to acquire property, plant and equipment, and intangible assets other than goodwill.

**New standards and Interpretations not yet adopted**

In preparing these consolidated financial statements the Group used IFRS, effective as at December 31, 2008 and used them consistently in preparation of these consolidated financial statements.

A number of new Standards, amendments to Standards and Interpretations are not yet effective as at 31 December 2008, and have not been applied in preparing this consolidated financial statements. The Group plans to adopt these pronouncements when they become effective. Of these pronouncements, potentially the following will have an impact on the Group's operations.

- IFRS 8 *Operating Segments* introduces the "management approach" to segment reporting. IFRS 8 *Operating Segments*, which becomes mandatory for the Group's 2009 financial statements, will require the disclosure of segment information based on the internal reports regularly reviewed by the Group's Chief Operating Decision Maker in order to assess each segment's performance and to allocate resources to them. Currently the Group presents segment information in respect of its geographical and business segments (refer to Note 6 Segment Information).
- Revised IAS 1 *Presentation of Financial Statements* (2007) will become mandatory for the Group's 2009 consolidated financial statements. The Standard introduces the concept of total comprehensive income and requires presentation of all owner changes in equity in the statement of changes in equity, separately from non-owner changes in equity.
- Revised IAS 23 *Borrowing Costs* removes the option to expense borrowing costs and requires that an entity capitalise borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. The revised IAS 23 will become mandatory for the Group's 2009 financial statements. However this standard will not have any impact on the Group's financial statements as the Group already applies the allowed alternative treatment and capitalize interest for qualifying asset.
- Amended IAS 27 *Consolidated and Separate Financial Statements* (2008) requires accounting for changes in ownership interests by the Group in a subsidiary, while maintaining control, to be recognised as an equity transaction. When the Group loses control of a subsidiary, any interest retained in the former subsidiary will be measured at fair value with the gain or loss recognised in the income statement. The amendments to IAS 27, which become mandatory for the Group's 2010 consolidated financial statements, are not expected to have a significant impact on the consolidated financial statements.
- Amendments to IAS 32 *Financial instruments: Presentation* and IAS 1 *Presentation of Financial Statements – Puttable Financial Instruments and Obligations Arising on Liquidation* requires puttable instruments, and instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation, to be classified as equity if certain conditions are met. The amendments, which become mandatory for the Group's 2009 consolidated financial statements, with retrospective application required, are not expected to have any impact on the consolidated financial statements.
- Amendment to IAS 39 *Financial Instruments: Recognition and Measurement – Eligible Hedged Items* clarifies how the principles that determine whether a hedged risk or portion of cash flows is eligible for designation should be applied in particular situations. The amendment, which becomes mandatory for the Group's 2010 consolidated financial statements, with retrospective application required, is not expected to have any impact on the consolidated financial statements.

*(In thousands of RUR)*

- Revised IFRS 3 *Business Combinations* (2008) and amended IAS 27 (2008) *Consolidated and Separate Financial Statements*, which come into effect on 1 July 2009 (i.e. become mandatory for the Group's 2010 consolidated financial statements). The revisions address, among others, accounting for step acquisitions, require acquisition-related costs to be recognised as expenses and remove exception for changes in contingent consideration to be accounted by adjusting goodwill. The revisions also address how non-controlling interests in subsidiaries should be measured upon acquisition and require to recognise the effects of transactions with noncontrolling interest directly in equity.
- IFRIC 18 Transfers of Assets from Customers applies to the accounting for transfers of items of property, plant and equipment by entities that receive such transfers from their customers. The interpretation clarifies recognition and measurement of received items, how the resulting credit, as well as a transfer of cash from customers should be accounted for. IFRIC 18 is applied prospectively to transfers of assets from customers received on or after 1 July 2009.
- Amendments to IFRS 1 First-time adoption of International Financial Reporting Standards and IAS 27 Consolidated and Separate Financial Statements – *Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate* which will come into effect on 1 July 2009. The Group has not yet determined the potential effect of the amendment.
- Various Improvements to IFRSs have been dealt with on a standard-by-standard basis. All amendments, which result in accounting changes for presentation, recognition or measurement purpose, will come into effect not earlier than 1 January 2009. The Group has not yet analysed the likely impact of the improvements on its financial position or performance.

## 4. GROUP SUBSIDIARIES

The Group's consolidated financial statements include the following subsidiaries:

| Subsidiary | Principal activity | Ownership as at December 31, 2008, % | Ownership as at December 31, 2007, % |
|---|---|---|---|
| CHOP Energia | Security services | 80 | 39 |
| Kolenergostroyremont | Repair services | - | 65,5 |
| Karelelectrosetremont | Repair services | - | 100 |
| Lesnaya skazka | Recreation | 98 | 98 |
| Pskovenergoagent | Collection services | 100 | 49 |
| Pskovenergoservice | Repair services | - | 49 |
| Pskovenergosbyt | Sale of electricity | 100 | 49 |
| Pskovenergoavto | Transportation services | 100 | 49 |
| Mega-Press | Mass media | 70 | 70 |

Although as of December 31, 2007 the Group did not own more than half of the equity shares of CHOP Energia, Pskovenergoagent, Pskovenergoservice, Pskovenergosbyt, Pskovenergoavto, and consequently did not control more than half of the voting power of those shares, it had the power to appoint and remove the majority of the board of directors and control the entity through the board. Consequently, these companies are controlled by the Group and are consolidated in these financial statements.

During 2008 the Group disposed three of its subsidiaries. For details, refer to Note 5.

*(In thousands of RUR)*

## 5. DISPOSAL OF SUBSIDIARIES

During the year ended December 31, 2008 and 2007, the Group disposed several of its subsidiaries. The summary on these disposals are detailed in the table below:

| Subsidiary | Date of disposal | Sales proceeds | Net assets (liabilities) disposed of | Gain/(loss) on disposal |
|---|---|---|---|---|
| IA Severny Region | June 28, 2007 | 50 | (332) | 382 |
| Arkhangelsksetremont | September 21,2007 | 40,217 | 8,861 | 31,356 |
| Vologdasetremont | September 14, 2007 | 41,000 | 10,463 | 30,537 |
| Kolenergosetservis | September 21, 2007 | 44,381 | 27,148 | 17,233 |
| Elektrosetservis | September 21, 2007 | 17,882 | 10,924 | 6,958 |
| Novgorodelektrosetremont | September 21, 2007 | 34,266 | 11,346 | 22,920 |
| **Total** | | **177,796** | **68,410** | **109,386** |
| Karelelectrosetremont | February 8, 2008 | 27,010 | 18,413 | 8,597 |
| Kolenergostroyremont | June 6, 2008 | 3,020 | (56,134) | 59,154 |
| Pskovenergoservice | May 16, 2008 | 4,000 | 6,478 | (2,478) |
| **Total** | | **34,030** | **(31,243)** | **65,273** |

Assets and liabilities of the above subsidiaries were classified as held for sale as the management of the Group has committed to a plan to sell these subsidiaries. Active programme to locate a buyer and complete the plan have been initiated prior to January 1, 2007 and comprised the following as of December 31, 2007:

| | Karelelectroset remont | Kolenergostroy remont | Pskovenergo service | Total |
|---|---|---|---|---|
| Property, plant and equipment | 18,055 | 5,909 | 3,370 | 27,334 |
| Deferred tax asset | 1,867 | 18,004 | 91 | 19,962 |
| Inventory | 2,540 | 28,537 | 47 | 31,124 |
| VAT receivable | 201 | 12,448 | - | 12,649 |
| Trade and other receivables | 1,673 | 40,871 | 47 | 42,591 |
| Cash and cash equivalents | 981 | 176 | 3,852 | 5,009 |
| **Total** | **25,317** | **105,945** | **7,407** | **138,669** |
| | | | | 0 |
| Deferred tax liability | 982 | 992 | - | 1,974 |
| Taxes payable | 2,998 | 35,485 | - | 38,483 |
| Trade and other payables | 10,672 | 53,983 | 929 | 65,584 |
| | | | | 0 |
| **Total** | **14,652** | **90,460** | **929** | **106,041** |

Gain/(loss) on disposal was recognised as other non-operating income/(expenses) in the income statement.

## 6. SEGMENT INFORMATION

Geographical segments – primary reporting format. The management selected geographical segments as primary reporting format based on the fact that regional characteristics play important role in business decisions and such segments are unique in terms of risks and tariffs regulation.

For the purpose of these financial statements the reportable segments are determined based on the Group's geographical regional profile. As at December 31, 2008 the Group is organised into seven operating segments based on former RAO UES Regional Distribution Grid Companies and include Murmansk, Karelia, Pskov, Arkhangelsk, Novgorod, Komi, Vologda regions.

Management Company which is not included within any of the aforementioned reportable segments, is included in Corporate and other unallocated.

***(In thousands of RUR)***

| 2008 | Murmansk | Karelia | Pskov | Arkhangelsk | Novgorod | Komi | Vologda | Corporate and other unallocated | Eliminations | Total |
|---|---|---|---|---|---|---|---|---|---|---|
| Revenue from external customers | 3,155,153 | 2,511,191 | 3,404,550 | 2,875,591 | 2,164,045 | 5,115,121 | 4,007,153 | 15,743 | - | **23,248,547** |
| Intersegmental revenue | 14,633 | 141 | 2,276,519 | 14 | 55 | 11 | 36,180 | 78,547 | (2,406,100) | **-** |
| Segment result | 138,231 | 234,055 | (100,261) | (373,536) | 566,362 | 633,195 | 524,367 | (547,345) | - | **1,075,068** |
| Segment assets | 4,870,402 | 2,941,965 | 4,278,302 | 4,343,522 | 3,023,923 | 6,431,726 | 5,821,457 | 534,954 | (169,381) | **32,076,870** |
| Segment liabilities | (1,259,750) | (1,155,323) | (778,478) | (1,474,007) | (591,026) | (1,534,476) | (1,212,497) | (3,299,522) | 169,381 | **(11,135,698)** |
| Capital expenditure | 527,398 | 438,559 | 463,079 | 349,458 | 767,838 | 1,087,810 | 749,026 | 62,291 | - | **4,445,459** |
| Depreciation and amortization | (224,346) | (153,151) | (355,477) | (342,034) | (250,868) | (336,483) | (483,415) | (22,532) | - | **(2,168,306)** |

| 2007 | Murmansk | Karelia | Pskov | Arkhangelsk | Novgorod | Komi | Vologda | Corporate and other unallocated | Eliminations | Total |
|---|---|---|---|---|---|---|---|---|---|---|
| Revenue from external customers | 2,790,723 | 2,349,690 | 3,079,470 | 2,962,891 | 2,046,716 | 3,968,650 | 4,026,134 | 55,426 | - | **21,279,700** |
| Intersegmental revenue | 5,783 | 102 | 2,062,775 | 1,840 | - | - | - | 239,447 | (2,309,947) | **-** |
| Segment result | (33,872) | 157,079 | (8,726) | 69,861 | 351,207 | 196,826 | 254,610 | (151,265) | - | **835,720** |
| Segment assets | 4,745,914 | 2,207,889 | 4,066,720 | 4,370,114 | 2,637,585 | 5,134,508 | 5,264,964 | 94,885 | (263,629) | **28,258,950** |
| Segment liabilities | (846,852) | (518,781) | (426,241) | (594,083) | (711,778) | (926,320) | (952,611) | (3,679,809) | 263,629 | **(8,392,846)** |
| Capital expenditure | 406,010 | 367,031 | 388,398 | 306,466 | 612,393 | 871,905 | 817,470 | 7,239 | - | **3,776,912** |
| Depreciation and amortization | (204,690) | (120,865) | (331,194) | (307,202) | (169,768) | (308,994) | (433,483) | (2,725) | - | **(1,878,921)** |

*(In thousands of RUR)*

**Business segments – secondary reporting segments**

The secondary reporting segments are business segments. The Group has two business segments – distribution of electricity and sale of electricity to final customers. The information for the year ended December 31, 2008 and 2007 is presented below:

| 2008 | Distribution of electricity | Sale to final customers | Corporate and other unallocated | Total |
|---|---|---|---|---|
| Revenue from external customers | 19,914,940 | 3,317,864 | 15,743 | **23,248,547** |
| Segment assets | 31,350,522 | 191,681 | 534,667 | **32,076,870** |
| Capital expenditure | 4,382,505 | 663 | 62,291 | **4,445,459** |

| 2007 | Distribution of electricity | Sale to final customers | Corporate and other unallocated | Total |
|---|---|---|---|---|
| Revenue from external customers | 18,345,824 | 2,878,450 | 55,426 | **21,279,700** |
| Segment assets | 28,029,407 | 146,760 | 82,783 | **28,258,950** |
| Capital expenditure | 3,768,467 | 1,206 | 7,239 | **3,776,912** |

## 7. SALARIES AND OTHER PERSONNEL EXPENSES

| | December 31, 2008 | December 31, 2007 |
|---|---|---|
| Post employment benefits | | |
| Defined contribution plan | 998,947 | 795,483 |
| Defined benefit plan (Note 19) | (85,087) | 197,435 |
| Other employee benefits | 4,598,371 | 4,744,844 |
| **Total** | **5,512,231** | **5,737,762** |

## 8. FINANCIAL COSTS, NET

| | December 31, 2008 | December 31, 2007 |
|---|---|---|
| Interest expense on loans | 311,089 | 128,947 |
| Interest expense on leasing | 16,600 | 21,311 |
| Discounting of long-term accounts receivable | 3,243 | - |
| Less: amounts included in the cost of qualifying assets | (183,572) | (46,928) |
| **Total Financial Expenses** | **147,360** | **103,330** |
| Rewinding of discount | (28,001) | (24,358) |
| Interest income | (4,791) | (5,102) |
| **Total Financial Income** | **(32,792)** | **(29,460)** |
| **Total Financial Costs, Net** | **114,568** | **73,870** |

Capitalization rate for general purpose borrowings is 10.13% (2007: 8.97%).

*(In thousands of RUR)*

## 9. INCOME TAX

Income tax recognised in profit or loss

| | Year ended December 31, 2008 | Year ended December 31, 2007 |
|---|---|---|
| Current tax | 193,473 | 408,729 |
| Fines | 25,686 | - |
| Deferred income tax | 329,058 | 100,050 |
| Effect of the change in tax rate | (372,958) | - |
| **Total Income Tax Expense** | **175,259** | **508,779** |

Profit before income tax for the year is reconciled to income tax expense as follows:

| | Year ended December 31, 2008 | Year ended December 31, 2007 |
|---|---|---|
| Profit before income tax | 1,250,327 | 1,344,499 |
| Theoretical income tax at Russian statutory rate of 24% | 300,078 | 322,680 |
| Adjustments due to: | | |
| Permanent tax differences (non-deductible expenses) | 222,453 | 186,099 |
| Net effect of change in tax rate | (372,958) | - |
| Fines | 25,686 | - |
| **Income tax expense** | **175,259** | **508,779** |

The statutory tax rate effective in the Russian Federation was 24% in 2008 and 2007. In November 2008, an amendment to the Tax Code was enacted to reduce corporate income tax from 24% to 20% effective from 1 January 2009. The effect of change in the tax rate presented above represents the application of reduced tax rate to deferred tax balances as of December 31, 2008.

*(In thousands of RUR)*

Differences between IFRS and statutory taxation regulations of the Russian Federation give rise to temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and their tax bases. The tax effect of the movements in these temporary differences is detailed below and is recorded at the aforementioned effective rates:

| | **December 31, 2007** | **Movement for the year recognised in income statement** | **December 31, 2008** |
|---|---|---|---|
| Accounts receivable | 177,320 | (151,933) | 25,387 |
| Leasing | 54,998 | (34,324) | 20,674 |
| Pension plan | 307,367 | (105,476) | 201,891 |
| Other current liabilities and accrued expenses | 209,370 | (103,472) | 105,898 |
| Other assets/ liabilities | - | 13,322 | 13,322 |
| **Deferred tax assets** | **749,055** | **(381,883)** | **367,172** |
| Net-off | (745,290) | 378,687 | (366,603) |
| **Net deferred tax assets** | **3,765** | **(3,196)** | **569** |
| | | | |
| Property, plant and equipment | (2,655,520) | 423,559 | (2,231,961) |
| Other assets/ liabilities | (2,224) | 2,224 | - |
| **Deferred tax liabilities** | **(2,657,744)** | **425,783** | **(2,231,961)** |
| Net-off | 745,290 | (378,687) | 366,603 |
| **Net deferred tax liabilities** | **(1,912,454)** | **47,096** | **(1,865,358)** |

| | **January 1, 2007** | **Movement for the year recognised in income statement** | **December 31, 2007** |
|---|---|---|---|
| Accounts receivable | 208,070 | (30,750) | 177,320 |
| Prior year losses | 84,955 | (84,955) | - |
| Leasing | 40,772 | 14,226 | 54,998 |
| Pension plan | 285,651 | 21,716 | 307,367 |
| Other current liabilities and accrued expenses | 162,775 | 46,595 | 209,370 |
| Other assets/ liabilities | 28,051 | (28,051) | - |
| **Deferred tax assets** | **810,274** | **(61,219)** | **749,055** |
| Net-off | (806,911) | 61,621 | (745,290) |
| **Net deferred tax assets** | **3,363** | **402** | **3,765** |
| | | | |
| Property, plant and equipment | (2,618,913) | (36,607) | (2,655,520) |
| Other assets/ liabilities | - | (2,224) | (2,224) |
| **Deferred tax liabilities** | **(2,618,913)** | **(38,831)** | **(2,657,744)** |
| Net-off | 806,911 | (61,621) | 745,290 |
| **Net deferred tax liabilities** | **(1,812,002)** | **(100,452)** | **(1,912,454)** |

Based upon historical taxable income and projection for future taxable income over the periods in which deferred income tax assets are deductable, management of the Group believes it is more likely than not that the Group will realize the benefits of the deductable differences.

*(In thousands of RUR)*

## 10. PROPERTY, PLANT AND EQUIPMENT

| | Building and structures | Power transmission lines | Power conversion equipment | Other | Assets under construction | Total |
|---|---|---|---|---|---|---|
| ***Cost/deemed cost*** | | | | | | |
| **At January 1, 2007** | **3,122,201** | **15,304,189** | **2,850,608** | **1,417,439** | **421,203** | **23,115,640** |
| Additions and transfers | 323,294 | 859,362 | 919,923 | 699,603 | 850,379 | 3,652,561 |
| Disposals | (19,942) | (59,727) | (25,746) | (47,779) | (53,769) | (206,963) |
| **At December 31, 2007** | **3,425,553** | **16,103,824** | **3,744,785** | **2,069,263** | **1,217,813** | **26,561,238** |
| Additions and transfers | 445,095 | 1,157,090 | 1,747,197 | 593,725 | 382,844 | 4,325,951 |
| Disposals | (9,550) | (27,280) | (7,174) | (73,615) | (30,301) | (147,920) |
| **At December 31, 2008** | **3,861,098** | **17,233,634** | **5,484,808** | **2,589,373** | **1,570,356** | **30,739,269** |
| ***Depreciation*** | | | | | | |
| **At January 1, 2007** | **-** | **-** | **-** | **(41,693)** | **-** | **(41,693)** |
| Charge for the year | (165,592) | (1,088,786) | (291,513) | (284,806) | - | (1,830,697) |
| Eliminated on disposals | 566 | 5,578 | 1,908 | 7,582 | - | 15,634 |
| **At December 31, 2007** | **(165,026)** | **(1,083,208)** | **(289,605)** | **(318,917)** | **-** | **(1,856,756)** |
| Charge for the year | (184,070) | (1,159,525) | (362,553) | (344,978) | - | (2,051,126) |
| Eliminated on disposals | 1,150 | 3,398 | 1,860 | 18,254 | - | 24,662 |
| **At December 31, 2008** | **(347,946)** | **(2,239,335)** | **(650,298)** | **(645,641)** | **-** | **(3,883,220)** |
| ***Net book value*** | | | | | | |
| **At January 1, 2007** | **3,122,201** | **15,304,189** | **2,850,608** | **1,375,746** | **421,203** | **23,073,947** |
| **At December 31, 2007** | **3,260,527** | **15,020,616** | **3,455,180** | **1,750,346** | **1,217,813** | **24,704,482** |
| **At December 31, 2008** | **3,513,152** | **14,994,299** | **4,834,510** | **1,943,732** | **1,570,356** | **26,856,049** |

The deemed cost of property, plant and equipment of the branches, which were merged into the Group, was determined by reference to its fair value as of January 1, 2007, the date of transition to IFRS (see Note 3). The fair value and estimated remaining useful life as of January 1, 2007 was determined by the independent appraiser, comprised of the consortium of Deloitte and Touche, «The Institute for Enterprise Issues» LLC, and «AKF «Top-Audit» LLC. The appraisal was performed in accordance with International Standards on Appraisal.

The majority of the Group'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 in the Russian Federation and does not provide a sufficient number of sales of comparable property, plant and equipment for using a market-based approach for determining fair value.

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

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

In addition to the determination of the depreciated replacement cost, cash flow testing was conducted in order to assess the reasonableness of those values, which resulted in the depreciated replacement cost values being decreased by RUR 68,454,663 thousand in arriving at the above value. Each branch was appraised as major and specialized pecuniary complex, which can not be sold independently on the free market. For such assets, the reproduction cost less depreciation was used. However, some assets included in the complex could be appraised at market value.

As a the result of the appraisal, the net book value of the appraised property, plant and equipmet increased from RUR 20,348,049 thousand, reflected in the statutory financial statement, to RUR 23,073,947 thousand in these consolidated financial statements as of January 1, 2007.

The Group leases vehicles under a number of finance lease agreements. At the end of the term of the lease the Group takes automatic ownership of the assets or has an option to purchase leased assets at a beneficial price. Finance leases obligations are secured by the lessor's title to the leased assets (Note 18). The carrying value of such assets is RUR 356,603 thousand (2007: RUR 468,650 thousand). Those assets are included in other property.

Included in the construction-in-progress as at December 31, 2008 advances paid for the acquisition of the property, plant and equipment in the amount of RUR 326,421 thousand (2007: 201,615 thousand).

The Group management analyses the indication of impairment due to volatility of markets and ongoing global financing and economic crisis. The Groups property, plant and equipment and intangible assets are tested for impairment at each balance sheet date separately for each cash-generating unit.

The recoverable amounts represent their value in use determined by discounting the nominal future cash flows of each cash-generating unit generated from their continuing use and ultimate disposal.
The following key assumptions were used in performing the cash flow testing as at 31 December 2008:

- Cash flows were projected based on Group budgets and official forecasted scenarios of the Russian electric power sector development prepared by CJSC Energy Forecasting Agency (the agency was established in 2005 by the national holding company JSC RAO UES of Russia for monitoring, analysis and forecasting the development of Russian electric power sector).

- Cash flows were calculated separately for each of the 7 Cash Generating Units ("CGU"), being the regional network companies (individual branches from the merger on 1 April 2008).

- Cash flows were extrapolated assuming no further growth in production volume from 2009, and revenue and expenses increasing in line with above-mentioned scenarios.

- In the assessment of cash flows, possible changes in electricity pricing and basic macroeconomic conditions making an impact on the Group's business practice were considered.

- A discount rate of 13.2% was applied in determining the recoverable amount of the CGU. The discount rate was estimated based on the Group's post-tax incremental borrowing rate at the reporting date.

- 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 (historical data).

The result of the impairment testing at the reporting dates does not give rise to any impairment charge. The sensitivity analysis shows, that change in the discount rate by 4.5 percentage points does not give rise to impairment charges.

***(In thousands of RUR)***

## 11. INTANGIBLE ASSETS

| | Software | Licences | Total |
|---|---|---|---|
| *Cost* | | | |
| **At January 1, 2007** | **31,149** | **27,007** | **58,156** |
| Additions | 56,421 | 67,930 | 124,351 |
| **At December 31, 2007** | **87,570** | **94,937** | **182,507** |
| Additions | 56,788 | 62,720 | 119,508 |
| **At December 31, 2008** | **144,358** | **157,657** | **302,015** |
| *Amortization* | | | |
| **At January 1, 2007** | **(402)** | **-** | **(402)** |
| Charge for the year | (20,549) | (27,676) | (48,225) |
| **At December 31, 2007** | **(20,951)** | **(27,676)** | **(48,627)** |
| Charge for the year | (53,818) | (63,362) | (117,180) |
| **At December 31, 2008** | **(74,769)** | **(91,038)** | **(165,807)** |
| *Net book value* | | | |
| **At January 1, 2007** | **30,747** | **27,007** | **57,754** |
| **At December 31, 2007** | **66,619** | **67,261** | **133,880** |
| **At December 31, 2008** | **69,589** | **66,619** | **136,208** |

## 12. INVESTMENTS IN SECURITIES AND OTHER FINANCIAL ASSETS

| | December 31, 2008 | December 31, 2007 |
|---|---|---|
| **Non-current** | | |
| **Available-for-sale investments, at fair value** | | |
| Equity securities | 9,059 | 15,523 |
| **Loans and receivables, at amortized cost** | | |
| Restructured trade receivables from principal activities | 62,354 | 112,905 |
| Non-current receivables from sales of apartments to employees | 31,386 | 36,749 |
| Long-term promissory notes | 3,213 | 12,386 |
| **Total non-current** | **106,012** | **177,563** |

Equity securities represent investments in shares of TGC-1 and other securities, recorded at fair market value.

The restructured trade receivables represent amounts due for electricity for prior periods, which were past-due and in respect of which the agreement to settle such receivables in the course of several years was reached. The receivables from sale of apartments to employees originate from long-term loans, granted to employees for the purpose of apartments purchases and repayable on the monthly basis from their salary. As at December 31, 2008 the receivables in the amount of RUR 12,717 thousand from sale of apartments are pledged by the amount of RUR 93,102 thousand of cost of these apartments (as at December 31, 2007: RUR 19,597 thousand).

Long-term promissory notes represent investments in non-interest-bearing promissory notes of MDM-Bank with the maturity date of September 21, 2016.

All non-current receivables are RUR-denominated.

*(In thousands of RUR)*

## 13. ACCOUNTS RECEIVABLE

| | December 31, 2008 | December 31, 2007 |
|---|---|---|
| Trade receivables from principal activities | 3,353,154 | 2,136,947 |
| Trade receivables from other sales | 144,797 | 31,578 |
| Promissory notes | 52,000 | 15,010 |
| Other receivables | 129,278 | 301,020 |
| Less: allowance for doubtful debts | (609,153) | (1,395,559) |
| **Total** | **3,070,076** | **1,088,996** |

Short-term promissory notes at December 31, 2008 represent investment in the promissory notes of Sberbank (2007: Uralsib).

All accounts receivables are RUR-denominated.

The above Accounts Receivable includes Accounts Receivable from related parties (Note 22).

All impaired receivables have been provided for. Management has determined the allowance for doubtful debtors based on specific customer identification, customer payment trends, subsequent receipts and settlements and the analysis of expected future cash flows. Management believes that the group entities 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.

Certain trade receivables and other accounts receivable have been restructured and are due to be realized more than one year from the balance sheet date (Note 12).

Ageing of impaired receivables:

| | December 31, 2008 | December 31, 2007 |
|---|---|---|
| Less than 90 days | 4,539 | 24,434 |
| 90 – 180 days | 8,394 | 572 |
| 180– 365 days | 31,847 | 2,976 |
| Thereafter | 564,373 | 1,367,577 |
| **Total** | **609,153** | **1,395,559** |

Movement in the allowance for doubtful debt in respect of trade and other receivables:

| | December 31, 2008 | December 31, 2007 |
|---|---|---|
| **Balance at beginning of the year** | **(1,395,559)** | **(1,613,190)** |
| Recognised in the income statement | (51,515) | (37,705) |
| Amounts written-off as uncollected | 837,921 | 255,336 |
| **Balance at end of the year** | **(609,153)** | **(1,395,559)** |

*(In thousands of RUR)*

Recognition of provision for impaired receivables was included in other operating expenses in the income statement. Amounts charged to the provision account are generally written off when there is no expectation of recovering additional cash.

Other classes within trade and other receivables do not contain impaired assets.

The maximum exposure to credit risk at the reporting date is the carrying value of each class of receivable mentioned above plus the amount of promissory notes receivable, cash and cash equivalents, and other non-current assets. The Group does not hold any collateral as security on accounts receivable.

## 14. INVENTORIES

| | December 31, 2008 | December 31, 2007 |
|---|---|---|
| Spare parts and consumables for repairs | 317,155 | 318,505 |
| Fuel and oils | 177,205 | 127,012 |
| Working clothes and fittings | 52,376 | 39,691 |
| Emergency stock | 99,510 | 65,619 |
| Other inventories | 103,408 | 53,207 |
| Less: provision for obsolete and slow-moving inventories | (2,323) | (21,198) |
| **Total** | **747,331** | **582,836** |

As of 31 December 2008 certain inventories with a carrying amount of RUR 15,000 thousand (2007: RUR 15,000 thousand) have been pledged to secure bank loans and borrowings of the Group (Note 17).

## 15. CASH AND CASH EQUIVALENTS

| | December 31, 2008 | December 31, 2007 |
|---|---|---|
| Current accounts RUR - denominated | 716,193 | 678,254 |
| Special bank accounts | 1,563 | 2,038 |
| Other cash and cash equivalents | 906 | 1,247 |
| **Total** | **718,662** | **681,539** |

The Group has accounts in several Russian banks, including Sberbank, Vneshtorgbank, Gasprombank, Alfa-Bank, Rosbank, Baltiiskii bank, Uralsib and others.

## 16. EQUITY

### Basis of presentation of movements in equity

The Group was formed by the combination of a number of businesses under common control. Because of the consequent use of the predecessor basis of accounting (Note 3), the principal component of the net equity recognized for the group is based on the historic carrying value of the net assets of the businesses contributed as recorded in the IFRS financial records of the predecessor enterprises, rather than the fair values of those net assets. Similarly, for the purpose of comparability, the equity of the Group has been presented for comparative periods and as at January 1, 2007 as if the current group structure had existed from January 1, 2007 (Note 4). As the Group was formed as a result of share issue completed after January 1, 2007, the equity statement reflects additions to share capital in the amount equal to the statutory nominal value of the shares issued. In accordance with the predecessor accounting, the effect of such statement also reflects the impact of distributing the minority interest to the parent Company of the Group.

**Merger reserve**

Based on application of predecessor accounting (Note 3), as of January 1, 2007 the difference of RUR 10,439,687 thousand between the value of share capital issued and the IFRS carrying values of the contributed assets and the minority interest was recorded as merger reserve within equity.

Profit for the year, allocated to the merger reserve, includes earnings of the subsidiaries, until they were legally merged into the Company as of April 1, 2008.

**Authorised, issued and fully paid share capital**

As of December 31, 2008 authorised and issued share capital comprised 95,785,923,138 ordinary shares (2007: 10,000,000) of which all ordinary shares were issued and fully paid. All shares have par value of RUR 0.1.

At April 1, 2008 the Group increased it's share capital by RUR 9,568,592 thousand by conversion of ordinary and preference shares of JSC "Arkhenergo", JSC "Vologdaenergo", JSC "AEK Komienergo", JSC "Novgorodenergo", JSC "Pskovenergo", JSC "Karelenergo", JSC "Kolenergo" into the ordinary shares of the Company.

**Retained earnings and dividends**

The Company's statutory accounts form the basis for the profit distribution and other appropriations. For the years ended December 31, 2008 and 2007, the statutory profit of the Company were RUR 598,241 thousand and RUR 1,162 thousand, respectively.

**Voting rights of shareholders**

The holders of fully paid ordinary shares are entitled to one vote per share at the Company's annual and general shareholders' meetings.

**Earnings per share**

The amount of earnings per share was calculated by the weighted average number of ordinary shares as if the business combination among the Group entities took place as of January 1, 2007 (refer to Note 2 for basis of preparation of these financial statements).

There are no instruments, convertible to equity, so diluted earnings per share equal to basic earnings per share.

*(In thousands of RUR)*

## 17. LOANS AND BORROWINGS

Long-term borrowings as at December 31 comprised of the following:

| | Annual interest rate | Effective interest rate | December 31, 2008 | December 31, 2007 |
|---|---|---|---|---|
| **Secured bank loans** | | | | |
| Gasprombank | 17% | 17% | 495,000 | 324,500 |
| GUP Komi Respublikansky Centr Energosnabgeniya | 7% | 7% | 9,750 | 13,000 |
| **Unsecured bank loans** | | | | |
| VTB Severo-Zapad | 14%-17% | 14%-17% | 1,329,335 | - |
| Novgorodskie Oblastnie Elektricheskie Seti | 0% | 0% | 18,800 | 18,800 |
| **Total** | | | **1,852,885** | **356,300** |
| Less current portion of long-term borrowings | | | (284,696) | (3,248) |
| **Total long-term loans and borrowings** | | | **1,568,189** | **353,052** |

Short-term borrowings as at December 31 comprised of the following:

| | Annual interest rate | Effective interest rate | December 31, 2008 | December 31, 2007 |
|---|---|---|---|---|
| **Secured bank loans** | | | | |
| Pfleiderer | 100 EUR | 15.7% | - | 22,938 |
| **Unsecured bank loans** | | | | |
| Alfa-bank | MOSIBOR1M+ 4.5% | MOSIBOR1M+ 4.5% | - | 150,000 |
| Gazprombank | 7.3-9.6% | 7.3-9.6% | - | 100,000 |
| Gazprombank | 17% | 17% | 1,175,000 | - |
| Rosbank | 8%-8.45% | 8%-8.45% | - | 260,875 |
| Rosbank | 11%-15% | 11%-15% | 480,000 | - |
| VTB Severo-Zapad | 8%-9% | 8%-9% | - | 263,442 |
| VTB Severo-Zapad | 8.5%-16% | 8.5%-16% | 1,078,532 | - |
| Sberbank | 9%-11% | 9%-11% | - | 510,000 |
| Sberbank | 11% | 11% | 100,000 | - |
| Baltiisky Bank | 9% | 9% | - | 40,000 |
| Accrued interest | | | 14,770 | 1,949 |
| Current portion of long-term borrowings | | | 284,696 | 3,248 |
| **Total short-term loans and borrowings** | | | **3,132,998** | **1,352,452** |

All loans and borrowings are RUR-denominated.

*(In thousands of RUR)*

The loans and borrowings are repayable as follows:

| | December 31, 2008 | December 31, 2007 |
|---|---|---|
| Due within three months | 810,872 | 792,070 |
| Due from three to six months | 728,569 | 172,846 |
| Due from six months to twelve months | 1,593,557 | 387,536 |
| **Total current portion repayable in one year** | **3,132,998** | **1,352,452** |
| Due in the second year | 1,352,795 | 154,279 |
| Due thereafter | 215,394 | 198,773 |
| **Total long-term loans and borrowings** | **1,568,189** | **353,052** |

The following items of inventories and future revenues were pledged to secure loans and borrowings:

| | December 31, 2008 | December 31, 2007 |
|---|---|---|
| Inventories (refer to Note 14) | 15,000 | 15,000 |
| Future cash collection | 652,726 | 652,726 |
| Own promissory notes | - | 22,938 |
| **Total** | **667,726** | **690,664** |

Pledge of the future cash collection is the right of the creditor to receive cash, which will be earned by the Group in the future.

## 18. OBLIGATION UNDER FINANCE LEASES

| | Actual lease payments | | Present value of actual lease payments | |
|---|---|---|---|---|
| | December 31, 2008 | December 31, 2007 | December 31, 2008 | December 31, 2007 |
| Less than one year | 61,027 | 141,929 | 53,556 | 126,634 |
| Between one and five years | 51,585 | 112,612 | 49,814 | 102,526 |
| | 112,612 | 254,541 | 103,370 | 229,160 |
| Less: Future finance charges | (9,242) | (25,381) | - | - |
| **Present value of actual lease payments** | **103,370** | **229,160** | **103,370** | **229,160** |
| Included in the consolidated balance sheet as: | | | | |
| current obligations under finance lease | | | 53,556 | 126,634 |
| long-term obligations under finance lease | | | 49,814 | 102,526 |

The Group leases vehicles under a number of finance lease agreements. The average lease term is 2 years. For the year ended December 31, 2008 the weighted average effective interest rate was 10.24% (2007: 10.02%). All leases are on a fixed repayment basis and denominated in RUR. The Group's obligations under finance leases are secured by the lessors' title to the leased assets. The fair value of the finance lease liabilities is approximately equal to their carrying amount.

*(In thousands of RUR)*

## 19. RETIREMENT BENEFIT OBLIGATIONS

In accordance with the "Regulation on Non-State Pension Benefits" adopted by the Group, the Group funds contributions to the personal accounts for employees covered by the plan, maintained by Non-State Pension Fund of electrical energy industry ("NPFE"), which is separate legal entity. Under this defined benefit plan employees are entitled to retirement benefit which consists of a one-time retirement payment and lifetime pension payments.

The Group is also obliged to pay to its employees certain benefits according to the collective labor agreements. The most significant defined benefit obligations recognized by the Group as at the reporting dates were:

- Lump sum paid at retirement;
- Jubilee benefits;
- Travel fare remuneration;
- Periodical benefits after retirement;
- Payments in case of death after retirement;
- Pensioners' annual benefits;
- Payments in case of death by industrial accident.

The most recent actuarial valuation of the defined benefit obligation was carried out at 31 December 2008 by an independent actuary. The present value of the defined benefit obligation, and related current service costs and past service cost, were measured using the Projected Unit Credit Method.

The tables below provide information about the benefit obligation, plan assets and actuarial assumptions used for the year ended 31 December 2008 and 2007.

At 31 December 2008 and 2007, the principal actuarial assumptions used in determining the present value of benefit obligations and net periodic pension expenses were as follows:

| | 2008 | 2007 |
|---|---|---|
| Discount rate | 9% | 6.4% |
| Expected salary increase | 9% | 10% |
| Inflation rate | 8% | 7.3% |
| Mortality table | Russian 1998 | Russian 1998 |
| Expected return on plan assets | 10% | 7% |

Movements in the present value of the defined benefit obligations in the current period were as follows:

| | Year ended December 31, 2008 | Year ended December 31, 2007 |
|---|---|---|
| **Balance at beginning of the year** | **1,447,257** | **1,327,525** |
| Current service cost | 122,246 | 134,618 |
| Interest on obligation | 88,651 | 81,859 |
| Benefits paid | (124,160) | (96,953) |
| Past service cost | 494,845 | - |
| Curtailment gain | (113,103) | - |
| Actuarial losses/(gains) | (280,508) | 208 |
| **Balance at end of the year** | **1,635,228** | **1,447,257** |

***(In thousands of RUR)***

Change in the plan assets was as follows:

| | Year ended December 31, 2008 | Year ended December 31, 2007 |
|---|---|---|
| **Balance at beginning of the year** | **157,947** | **137,314** |
| Expected return on plan assets | 13,227 | 9,962 |
| Contributions | 186,153 | 106,951 |
| Benefits paid | (124,161) | (96,953) |
| Actuarial gains | 376,705 | 673 |
| **Balance at end of the year** | **609,871** | **157,947** |

Plan assets comprise cash, invested by NPFE.

The actuarial (gains) /losses were recognized as follows:

| | December 31, 2008 | December 31, 2007 |
|---|---|---|
| 10% of defined benefit obligations at the beginning of the period | 123,891 | 100,053 |
| 10% of plan assets at the beginning of the period | 15,795 | 13,731 |
| Corridor limits | 123,891 | 100,053 |
| Average expected remaining working life | 7 | 7 |
| Cumulative unrecognized actuarial losses at the beginning of the period | 8,615 | - |
| Actuarial (gains)/losses due to change in defined benefit obligations | (280,508) | 208 |
| Actuarial losses due to change in plan assets | (376,705) | (673) |
| Amount of recognized actuarial gains | 101,995 | 9,080 |
| Recognition of gain due to curtailment | 35,360 | - |
| **Total unrecognized actuarial (gains)/losses** | **(511,243)** | **8,615** |

The unrecognized past service cost movements during the period were as follows:

| | Year ended December 31, 2008 | Year ended December 31, 2007 |
|---|---|---|
| **Balance at beginning of the year** | **-** | **-** |
| Past service costs arising during the period | 494,845 | - |
| Past service costs to be recognized during the period | 32,848 | - |
| **Balance at end of the year** | **527,693** | **-** |

***(In thousands of RUR)***

Amounts recognised in the consolidated balance sheet are as follows:

| | December 31, 2008 | December 31, 2007 |
|---|---|---|
| Present value of unfunded defined benefit obligation | 1,025,357 | 1,289,310 |
| Present value of funded defined benefit obligation | 609,871 | 157,947 |
| Total present value of obligations | 1,635,228 | 1,447,257 |
| Fair value of plan assets | (609,871) | (157,947) |
| Unrecognised actuarial gains/(losses) | 511,243 | (8,614) |
| Unrecognised past service cost | (527,693) | - |
| **Liability recognized in the balance sheet** | **1,008,907** | **1,280,696** |

Expenses/(income) recognised in the income statement were as follows:

| | Year ended December 31, 2008 | Year ended December 31, 2007 |
|---|---|---|
| Current service cost | 122,246 | 134,618 |
| Interest on obligation | 88,651 | 81,859 |
| Expected return on plan assets | (13,226) | (9,962) |
| Net actuarial (gains)/losses recognized | (101,995) | (9,080) |
| Past service cost recognized | (32,848) | - |
| Curtailment gain | (148,464) | - |
| **Total** | **(85,635)** | **197,435** |

Other than the defined benefit scheme liability outlined above, the Group was not liable for any supplementary pensions, post retirement health care, insurance benefits, or retirement indemnities to its current or former employees, as at December 31, 2008 and 2007.

## 20. ACCOUNTS PAYABLE AND ADVANCES RECEIVED

| | December 31, 2008 | December 31, 2007 |
|---|---|---|
| Trade payables | 850,372 | 565,000 |
| Unsettled liabilities for the acquisition of property, plant and equipment | 584,484 | 74,383 |
| Payables to employees | 691,190 | 1,059,581 |
| Advances received | 634,254 | 525,124 |
| Dividends payable | 17,330 | 22,290 |
| Other payables | 196,132 | 157,715 |
| **Total** | **2,973,762** | **2,404,093** |

No interest charge on the outstanding balance for trade and other payables during credit period. All payables are RUR-denominated.

*(In thousands of RUR)*

The table below summarises the maturity profile of the Group's trade and other payables as at December 31, 2008 and 2007:

| | December 31, 2008 | December 31, 2007 |
|---|---|---|
| Due within three months | 2,428,135 | 1,922,570 |
| Due from three to six months | 183,944 | 56,347 |
| Due from six months to twelve months | 361,683 | 425,176 |
| **Total** | **2,973,762** | **2,404,093** |

## 21. PROVISIONS

| | December 31, 2008 | December 31, 2007 |
|---|---|---|
| **Balance at beginning of the year** | **234,584** | **160,000** |
| Charges in the period | - | 104,584 |
| Provision used in the period | (197,610) | (30,000) |
| **Balance at end of the year** | **36,974** | **234,584** |

Provision as at December 31, 2008 represents claims with probable outcome in favour of tax authorities in the amount of RUR 36,974 thousand (as at December 31, 2007: RUR 234,584 thousand). The Group utilized in 2008 provision for tax claims of RUR 197,610 thousand as the result of lost tax litigation (2007: RUR 30,000 thousand).

## 22. RELATED PARTIES TRANSACTIONS AND OUTSTANDING BALANCES

Related parties include shareholders, affiliates and entities under common ownership and control with the Group and members of key management personnel.

The Owners include shareholders. As of December 31, 2008 the Group was controlled by JSC IDGC Holding, a state controlled entity (Note 1). JSC RAO UES was the main shareholder of the Group as of December 31, 2007 and had control over the Group's activity.

In the normal course of business the Group enters into transactions with other entities under common government control including Federal Grid Company, Russian railways, state-controlled banks and various governmental bodies. Prices for electricity and heat are based on tariffs set by federal and regional tariff regulatory bodies. Bank loans are provided on the basis of market rates. Taxes are accrued and settled in accordance with Russian tax legislation.

*(In thousands of RUR)*

During the year ended 31 December 2008 and 2007, Group entered into the following transactions with related parties that are not part of the Group:

### Transactions with related parties

| | Sales of goods and services | | Purchase of goods and services | |
|---|---|---|---|---|
| | Year ended December 31, 2008 | Year ended December 31, 2007 | Year ended December 31, 2008 | Year ended December 31, 2007 |
| **Companies under common control** | | | | |
| Electricity transportation | 4,703,456 | 15,629,680 | 5,984,463 | 6,282,307 |
| Electricity sales | 1,188,884 | 1,064,940 | 1,612,061 | 1,252,353 |
| Capital expenditures and repairs | 48,453 | 4,923 | 262,928 | 373,414 |
| Heating | 9,367 | - | 26,245 | 11,975 |
| Contributions to NPFE | - | - | 186,153 | 106,951 |
| Interest expensed and capitalized | - | - | 259,850 | 64,356 |
| Other | 431,800 | 297,290 | 577,041 | 860,710 |
| **The Owners** | | | | |
| Services provided by the parent | - | - | 34,223 | 88,607 |
| **Total** | **6,381,960** | **16,996,833** | **8,942,964** | **9,040,673** |

### Balances with related parties

| | Amounts owed to the Group | | Amounts owed by the Group | |
|---|---|---|---|---|
| | Year ended December 31, 2008 | Year ended December 31, 2007 | Year ended December 31, 2008 | Year ended December 31, 2007 |
| **Companies under common control** | | | | |
| Loans and borrowings | - | - | 4,201,215 | 1,212,522 |
| Electricity transportation | 268,430 | 740,985 | 374,125 | 351,613 |
| Electricity sales | 62,536 | 85,415 | 145 | 829 |
| Capital expenditures and repairs | 67,642 | 61,451 | 37,746 | 23,939 |
| Heating | 27,578 | 74,454 | 3,096 | 1,394 |
| Other | 150,793 | 212,402 | 66,117 | 61,948 |
| **The Owners** | | | | - |
| Settlement on services | - | 9,747 | 215 | 27,113 |
| **Total** | **576,979** | **1,184,454** | **4,682,659** | **1,679,358** |

The amounts outstanding are unsecured and will be settled in cash.

*(In thousands of RUR)*

### Compensation of key management personnel

The remuneration of key management personnel of the Group is represented by contractual salary and discretionary bonuses and amounted to:

| | Year ended December 31, 2008 | Year ended December 31, 2007 |
|---|---|---|
| **Key management personnel** | | |
| Amounts owed by the Group | 15,818 | 47,323 |
| Salaries and related expenses | 85,016 | 72,095 |

In addition to the above key management is entitled to long-term termination benefits.

## 23. COMMITMENTS AND CONTINGENCIES

### Political environment

The operations and earnings of the Group are affected by political, legislative, fiscal and regulatory developments, including those related to environmental protection. Because of the capital-intensive nature of the industry, the Group is also subject to physical risks of various kinds. The nature and frequency of these developments and events associated with these risks, which generally are not covered by insurance, as well as their effect on future operations and earnings, are not predictable.

### Taxation contingencies in the Russian Federation

The taxation system in the Russian Federation is at a relatively early stage of development, and is characterised by numerous taxes, frequent changes and inconsistent enforcement at federal, regional and local levels.

The government of the Russian Federation has commenced a revision of the Russian tax system and passed certain laws implementing tax reform. The new laws reduce the number of taxes and overall tax burden on businesses and simplify tax litigation. However, these new tax laws continue to rely heavily on the interpretation of local tax officials and fail to address many existing problems. Many issues associated with practical implication of new legislation are unclear and complicate the Group's tax planning and related business decisions.

In terms of Russian tax legislation, authorities have a period of up to three years to re-open tax declarations for further inspection. Changes in the tax system that may be applied retrospectively by authorities could affect the Group's previously submitted and assessed tax declarations.

While management believes that it has adequately provided for tax liabilities based on its interpretation of current and previous legislation, the risk remains that tax authorities in the Russian Federation could take differing positions with regard to interpretive issues. This uncertainty may expose the Group to additional taxation, fines and penalties that could be significant.

### Contingencies

In addition to the provision recognized by the Group for tax litigations as at December 31, 2008 (see Note 31) the Group is a defendant in several lawsuits with tax authorities, where the Group management believes that the outcome in favour of plaintiff is possibile. Possible contingencies as at December 31, 2008 amount to RUR 675,920 thousand (as at December 31, 2007: RUR 486,080 thousand).

*(In thousands of RUR)*

### Capital expenditure commitments

| | December 31, 2008 | December 31, 2007 |
|---|---|---|
| Commitments for the acquisition of property, plant and equipment | 1,919,724 | 764,451 |
| **Total** | **1,919,724** | **764,451** |

### Environmental matters

Group entities and their predecessor entities have operated in the electric power industry in the Russian Federation for many years. The enforcement of environmental regulation in the Russian Federation is evolving and the enforcement posture of Government authorities is continually being reconsidered. 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.

### Litigation

During the year, the Group was involved in a number of court proceedings (both as a plaintiff and as a defendant) arising in the ordinary course of business. In the opinion of management of the Group, there are no current legal proceedings or other claims outstanding, which could have a material effect on the result of operations, financial position or cash flows of the Group and which have not been accrued or disclosed in these consolidated financial statements.

### Insurance policies

The Russian insurance market is in the development stage and some forms of insurance protection common in other parts of the world are not yet generally available in the Russian Federation.

The Group has entered into insurance contracts to insure property, plant and equipment, and land transport and purchased accident, health and medical insurance for employees. Furthermore, the Group has purchased civil liability coverage for operating entities with dangerous production units.

As of December 31, 2008 the Group has insured its industrial assets for the amount of RUR 43,779,924 thousand (as of December 31, 2007: RUR 25,664,070 thousand). Also, as of December 31, 2008 the Group has insured vehicles below 10 years of age for the amount of RUR 299,952 thousand (as of December 31, 2007: RUR 227,968 thousand).

### Russian Federation risk

As an emerging market, the Russian Federation does not possess a fully developed business and regulatory infrastructure including stable banking and judicial systems, which would generally exist in a more mature market economy. The economy of the Russian Federation is characterized by a currency that is not freely convertible outside of the country, currency controls, low liquidity levels for debt and equity markets, and continuing inflation. As a result, operations in the Russian Federation involve risks that are not typically associated with those in more developed markets.
Stability and success of Russian economy and the Group's business mainly depends on the effectiveness of economic measures undertaken by the government as well as the development of legal and political systems.

*(In thousands of RUR)*

## 24. OPERATING LEASE ARRANGEMENTS

The Group leases land from municipal authorities. The Group does not have an option to purchase the leased assets at the expiry of the lease period.

| | December 31, 2008 | December 31, 2007 |
|---|---|---|
| Rental lease payments for the period | 61,601 | 54,797 |
| **Total** | **61,601** | **54,797** |

The operating lease commitments are as follows:

| | December 31, 2008 | December 31, 2007 |
|---|---|---|
| Not longer than 1 year | 47,343 | 45,616 |
| Longer than 1 year and not longer than 5 years | 140,451 | 139,022 |
| Longer than 5 years | 976,623 | 945,914 |
| **Total** | **1,164,417** | **1,130,552** |

## 25. FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of financial assets and liabilities is determined as follows:

- The fair value of financial assets and financial liabilities with standard terms and conditions and traded on active liquid markets are determined with reference to quoted market prices; and
- The fair value of other financial assets and financial liabilities (excluding derivatives) are determined in accordance with generally accepted pricing model based on discounted cash flow analysis using prices from observable current market transactions.

Management believes that the carrying values of financial assets (refer to Notes 26) and financial liabilities recorded at amortised cost in the financial statements approximate their fair values.

## 26. FINANCIAL RISK MANAGEMENT

### Financial risk factors

- The Group's activities expose it to a variety of financial risks, including:
- Liquidity risk – the threat of temporary inability to pay financial liabilities when they fall due;
- Credit risk – the threat of non-payment by counterparties on their liabilities;
- Market risks:
  - Interest rate risk – the threat of losses as a result of increases in the interest rates paid out by the Group on the borrowed funds;
  - Currency risks – the threat of losses during implementation of foreign economic or other currency transactions associated with changing of exchange rates of foreign currencies;
- Price risk – the risk of decreasing of price for electric power due to market mechanisms or intervention of the state; the risk of significant increase in price of fuel due to macroeconomic conditions or due to market monopolization.

The Group does not hedge finance risks.

**Capital risk management**

The Group manages its capital to ensure that entities of the Group will be able to continue as a going concern while maximising the return to the equity holder through the optimisation of the debt and equity balance. The management of the Group reviews the capital structure on a regular basis. Based on the results of this review, the Group takes steps to balance its overall capital structure through the payment of dividends, new share issues as well as the issue of new debt or the redemption of existing debt.

**Foreign currency risk**

Currency risk is the risk that the financial results of the Group will be adversely impacted by changes in exchange rates to which the Group is exposed. The foreign currency transactions, undertaken by the Group, are absolutely minimal.

**Interest rate risk**

Interest rate risk is the risk that changes in floating interest rates will adversely impact the financial results of the Group. The Group does not use any derivatives to manage interest rate risk exposure, at the same time the majority of the Group's financial assets and liabilities are at fixed rates and thus risk is limited.

The table below details the Group's sensitivity to increase or decrease of floating rate by 1%. The analysis was applied to loans and borrowings (financial liabilities) based on the assumptions that amount of liability outstanding as at the balance sheet date was outstanding for the whole year.

| | **MOSIBORIM – impact** | |
|---|---|---|
| | **Year ended December 31, 2008** | **Year ended December 31, 2008** |
| Profit or loss | - | 1,500 |

**Credit risk**

Credit risk is the risk that a counterparty will default on its obligations to the Group, leading to financial losses to the Group. Credit risk arises from cash and cash equivalents, deposits with banks as well as credit exposure to customers, including outstanding unsecured trade and other receivables.

Before accepting of any new customer, the Group uses an internal credit system to assess the potential customer's credit quality and defines credit limits separately for each individual customer. Credit limits attributable to customer is regularly reviewed at least on the annual basis. Of the receivables balance at the end of the year, the Group's ten largest customers (individually exceed 2% of the total balance) represent 96% (2007: 57%) from the outstanding balance.

The credit risk arising from the other financial assets of the Group, which comprise cash and cash equivalents, the Group's exposure to credit risk arises from default of the counterparty, with maximum exposure equal to the carrying value of these instruments.

*(In thousands of RUR)*

### Liquidity risk

Liquidity risk is the risk that the Group will not be able to settle all liabilities as they are due. The Group's liquidity position is carefully monitored and managed. The Group has in place a detailed budgeting and cash forecasting process to help ensure that it has adequate cash available to meet its payment obligations.

The summaries of maturity profile of the Group's financial liabilities as at December 31, 2008 and 2007 based on contractual payments are presented in Notes 17, 18 and 20.

### Major categories of financial instruments

The Group's principal financial liabilities comprise loans and borrowings, finance lease, trade payables and provisions and accruals. The main purpose of these financial instruments is to raise finance for the Group's operations. The Group has various financial assets such as trade receivables and loans given, cash and cash equivalents, and promissory notes.

| | December 31, 2008 | December 31, 2007 |
|---|---|---|
| **Financial assets** | | |
| Available-for-sale investments | 9,059 | 15,523 |
| Accounts receivable | 3,167,029 | 1,251,036 |
| Cash and cash equivalents | 718,662 | 681,539 |
| **Total financial assets** | **3,894,750** | **1,948,098** |
| **Financial liabilities** | | |
| Trade payables and accruals | (2,413,382) | (1,856,679) |
| Loans and borrowings | (4,701,187) | (1,705,504) |
| Finance leases | (103,370) | (229,160) |
| **Total financial liabilities** | **(7,217,939)** | **(3,791,343)** |

## 27. EVENTS SUBSEQUENT TO THE BALANCE SHEET DATE

### Dividends

The General shareholders meeting approved in June 2009 the decision not to pay out dividends for 2008.

### Changes in Group structure

On June 10, 2009 the Group's subsidiary Mega-Press was liquidated. The liquidation did not have any significant impact on the Group consolidated financial statements.

### Loans and Borrowings

In March and June 2009 the Group concluded loans agreements with Vneshtorgbank and Globeksbank with total credit limit of RUR 1,670,000 thousand.