JOINT STOCK COMPANY
TERRITORIAL GENERATING COMPANY №1
AND ITS SUBSIDIARY

CONSOLIDATED FINANCIAL STATEMENTS
PREPARED IN ACCORDANCE WITH
INTERNATIONAL FINANCIAL REPORTING STANDARDS
AND INDEPENDENT AUDITORS REPORT
31 DECEMBER 2008

Contents

PRICEWATERHOUSECOOPERS

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INDEPENDENT AUDITOR'S REPORT

To the Shareholders and Board of Directors of Joint-Stock Company Territorial Generating Company №1.

We have audited the accompanying consolidated financial statements of Joint-Stock Company Territorial Generating Company №1 and its subsidiary (the "Group") which comprise the consolidated balance sheet as at 31 December 2008 and the consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

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

ZAO PricewaterhouseCoopers Audit

01 June 2009
Moscow, Russian Federation

CONSOLIDATED BALANCE SHEET

(in thousands of Russian Roubles, except per share amounts)

	Notes	31 December 2008	31 December 2007
ASSETS			
Non-current assets			
Property, plant and equipment	6	64 090 439	44 039 533
Long-term investments	7	111 849	240 553
Deferred tax assets	8	352 847	200 962
Other non-current assets	9	1 341 598	2 049 211
Total non-current assets		**65 896 733**	**46 530 259**
Current assets			
Cash and cash equivalents	10	2 058 618	15 976 549
Available-for-sale investments	11	315 410	4 105 356
Accounts receivable and prepayments	12	8 250 770	6 043 126
Inventories	13	2 586 453	2 375 246
Total current assets		**13 211 251**	**28 500 277**
TOTAL ASSETS		**79 107 984**	**75 030 536**
EQUITY AND LIABILITIES			
Equity			
Share capital	14	38 543 414	38 509 598
Treasury shares	14	(2)	(6 740)
Share premium	14	22 913 678	23 271 781
Merger reserve	14	(6 086 949)	(6 086 949)
Fair value reserve		-	(93 560)
Retained earnings		4 581 594	3 530 184
Equity attributable to the shareholders of TGC-1		**59 951 735**	**59 124 314**
Minority interest		-	35 318
TOTAL EQUITY		**59 951 735**	**59 159 632**
Non-current liabilities			
Deferred tax liabilities	8	2 748 940	2 603 708
Long-term borrowings	15	2 283 930	1 343 349
Post-employment benefits obligations	16	686 266	604 021
Total non-current liabilities		**5 719 136**	**4 551 078**
Current liabilities			
Short-term borrowings and current portion of long-term borrowings	17	2 433 156	4 935 610
Accounts payable and accrued liabilities	18	10 382 213	6 134 241
Current income tax payable		151 746	-
Other taxes payable	19	469 998	249 975
Total current liabilities		**13 437 113**	**11 319 826**
TOTAL LIABILITIES		**19 156 249**	**15 870 904**
TOTAL EQUITY AND LIABILITIES		**79 107 984**	**75 030 536**

Approved for issue and signed on behalf of the Board of Directors on 1 June 2009.

General Director Vaynzikher B.F.

Chief Accountant Stanishevskaya R.V.

(in thousands of Russian Roubles, except per share amounts)

	Notes	Year ended 31 December 2008	Year ended 31 December 2007
Revenue			
Sales of electricity		17 745 494	14 249 974
Sales of heat		14 778 393	13 070 330
Other sales		1 065 665	925 896
Total revenue		**33 589 552**	**28 246 200**
Operating expenses, net	21	(33 736 902)	(28 204 965)
Impairment loss reversed during the year	3, 6	1 456 683	3 824 248
Impairment loss recognised during the year	3, 6	(277 234)	(55 501)
Total operating costs		**(32 557 453)**	**(24 436 218)**
Operating profit		**1 032 099**	**3 809 982**
Foreign exchange loss, net		(164 373)	(64 426)
Finance income	22	550 166	324 803
Finance cost	22	(280 194)	(574 882)
Profit before income tax		**1 137 698**	**3 495 477**
Income tax charge	8	(121 606)	(1 098 298)
Profit for the year		**1 016 092**	**2 397 179**
Attributable to:			
Shareholders of TGC-1		1 051 410	2 409 513
Minority interest		(35 318)	(12 334)
Earnings per share for profit attributable to the shareholders of TGC-1, basic and diluted (in Russian Roubles)	23	0.0003	0.0008

(in thousands of Russian Roubles, except per share amounts)

	Notes	Year ended 31 December 2008	Year ended 31 December 2007
Cash flows from operating activities			
Profit before income tax		1 137 698	3 495 477
Adjustments to reconcile profit before tax and net cash from operating activities:			
Depreciation of property, plant and equipment	6	2 750 427	2 044 821
Impairment loss reversed during the year	6	(1 456 683)	(3 824 248)
Impairment loss recognised during the year	6	277 234	55 501
Change in provision for impairment of accounts receivable	21	194 080	(28 767)
Impairment of available for sale investments	21	341 133	-
Change in financial assets through profit and loss		-	94 267
Finance income / (cost), net	22	(269 972)	250 079
Unrealised foreign exchange loss on non-operating items		164 373	56 397
Loss on disposal of subsidiaries	21	-	44 940
Change in provision for impairment of inventories	13	(23 027)	(2 034)
Loss on disposal of property, plant end equipment		56 800	98 434
Increase of post-employment benefits obligations		82 245	98 413
Other non-cash items		517	3 830
Operating cash flows before working capital changes		**3 254 825**	**2 387 110**
Increase in accounts receivable and prepayments		(2 607 480)	(2 822 308)
Increase in inventories		(188 180)	(167 079)
Increase in other non-current assets		(449 443)	-
Increase in accounts payable and accruals		168 807	1 989 174
Increase in taxes payable other than income tax		213 965	181 602
Cash generated from operations		**392 494**	**1 568 499**
Income tax paid		-	(223 516)
Interest paid		(335 665)	(553 330)
Net cash from operating activities		**56 829**	**791 653**
Cash flows from investing activities			
Purchase of property, plant and equipment		(16 681 506)	(13 854 592)
Proceeds from sale of property, plant and equipment		58 923	67 080
Proceeds from sale of subsidiaries		-	61 000
Proceeds from sale of long-term investments	7	-	795 965
Purchase of long-term investments	7	-	(20 000)
Net investments in bank deposits	11	3 829 831	(4 105 356)
Interest received		616 334	324 793
Net cash used in investing activities		**(12 176 418)**	**(16 731 110)**
Cash flows from financing activities			
Purchase of treasury shares	14	-	(20 558)
Proceeds from borrowings		2 503 087	8 787 100
Repayments of borrowings		(4 300 526)	(13 517 625)
Proceeds from issuance of bonds		-	4 000 000
Proceeds from share issue	14	-	32 400 000
Proceeds from sale of treasury shares	14	-	10 000
Dividends paid		(903)	(402 129)
Net cash (used in)/from financing activities		**(1 798 342)**	**31 256 788**
Net (decrease)/increase in cash and cash equivalents		**(13 917 931)**	**15 317 331**
Cash and cash equivalents at the beginning of the year		**15 976 549**	**659 218**
Cash and cash equivalents at the end of the year	10	**2 058 618**	**15 976 549**
Non-cash transactions from investing activities: purchase of PPE		**4 942 229**	**671 997**

(in thousands of Russian Roubles, except per share amounts)

	Equity attributable to the shareholders of TGC-1								
	Share capital	Treasury shares	Share premium	Merger reserve	Fair value reserve	Retained earnings	Total	Minority interest	Total equity
Balance at 31 December 2006	**29 022 225**	**(10 000)**	**-**	**(5 769 751)**	**42 780**	**1 505 975**	**24 791 229**	**103 426**	**24 894 655**
Fair value loss on available-for-sale investments (Note 7)	-	-	-	-	(179 395)	-	**(179 395)**	-	**(179 395)**
Deferred tax on fair value loss	-	-	-	-	43 055	-	**43 055**	-	**43 055**
Net loss recognised directly in equity	-	-	-	-	(136 340)	-	**(136 340)**	-	**(136 340)**
Profit for the year	-	-	-	-	-	2 409 513	**2 409 513**	(12 334)	**2 397 179**
Total recognised income for the year	-	-	-	-	(136 340)	2 409 513	**2 273 173**	(12 334)	**2 260 839**
Purchase of treasury shares (Note 14)	-	(6 740)	(13 818)	-	-	-	**(20 558)**	-	**(20 558)**
Sale of treasury shares (Note 14)		10 000	-	-	-	-	**10 000**	-	**10 000**
Dividends	-	-	-	-	-	(385 304)	**(385 304)**	-	**(385 304)**
Issuance of shares	9 257 143	-	23 142 857	-	-	-	**32 400 000**	-	**32 400 000**
Issuance of shares for the purpose of acquisition of Murmanskaya TPP (Notes 1,14)	230 230	-	142 742	(317 198)	-	-	**55 774**	(55 774)	**-**
Balance at 31 December 2007	**38 509 598**	**(6 740)**	**23 271 781**	**(6 086 949)**	**(93 560)**	**3 530 184**	**59 124 314**	**35 318**	**59 159 632**
Impairment of available-for-sale investment	-	-	-	-	123 105	-	**123 105**	-	**123 105**
Deferred tax on impairment of available-for-sale investment	-	-	-	-	(29 545)	-	**(29 545)**	-	**(29 545)**
Net loss recognised directly in equity	-	-	-	-	93 560	-	**93 560**	-	**93 560**
Profit for the year	-	-	-	-	-	1 051 410	**1 051 410**	(35 318)	**1 016 092**
Total recognised income for the year	-	-	-	-	93 560	1 051 410	**1 144 970**	(35 318)	**1 109 652**
Transaction costs for issuance of shares in 2007 (Note 14.1)	-	-	(422 308)	-	-	-	**(422 308)**	-	**(422 308)**
Issuance of shares for the purpose of merger with OJSC "TGC -1 Holding" (Note 1, 14)	33 816	6 738	64 205	-	-	-	**104 759**	-	**104 759**
Balance at 31 December 2008	**38 543 414**	**(2)**	**22 913 678**	**(6 086 949)**	**-**	**4 581 594**	**59 951 735**	**-**	**59 951 735**

Note 1. General Information

1.1 The Company and its operations

Joint-Stock Company (JSC) Territorial Generating Company № 1 (hereinafter "TGC-1", or the "Company") was established on 25 March 2005 within the framework of the Russian electricity sector restructuring in accordance with Resolution No. 181 adopted by the Board of directors of RAO UES of Russia (hereinafter "RAO UES") on 26 November 2004. The structure and principles of foundation of TGC-1 were adopted by the Board of Directors of RAO UES on 23 April 2004 (Resolution No. 168).

The Company was founded by three regional energy companies, all controlled by RAO UES: OJSC Lenenergo, OJSC Kolenergo and OJSC Karelenergogeneratsya.

On 1 November 2006, OJSC Petersburg Generating Company, OJSC Kolskaya Generating Company, OJSC Apatitskaya Thermal Power Plant and OJSC Karelenergogeneratsya, all controlled by RAO UES, were merged into TGC-1 and ceased to exist as separate legal entities. Since that time TGC-1 has been the owner of their generating assets.

In May 2007, the Company issued additional ordinary shares in order to exchange them for the shares of OJSC Murmanskaya Thermal Power Plant (hereinafter "Murmanskaya TPP") held by RAO UES and certain minority shareholders. After completion of the share exchange, the Company owns 84.06% of Murmanskaya TPP. The Company together with Murmanskaya TPP hereinafter is referred to as the Group.

As described in Note 14, in October 2007 the Company further increased its equity via additional issue of ordinary shares by closed subscription in favour of LLC Russian Energy Projects and Fortum Heat and Power Oy (Finland). The shareholding structure of the Company after this share issue is described in Note 1.3.

Following the reorganization process, an extraordinary general shareholder's meeting of RAO UES of Russia on 26 October 2007 decided to spin-off several holding companies to which shares in electricity generation companies, including OJSC TGC-1, held by RAO UES of Russia, were transferred. Holdings separated from RAO UES of Russia were merged with generation companies by means of shares conversion, which enabled the shareholders of RAO UES of Russia to receive direct shares in the generation companies after reorganization. Accordingly upon spin-off from RAO UES of Russia OJSC TGC-1 Holding (the "TGC-1 Holding") received the stake in OJSC TGC-1 held by RAO UES of Russia. Simultaneously with the spin-off, on 1 July 2008 TGC-1 Holding was merged with the Company and its shares were converted into the Company's shares.

On 29 October 2007 the Extraordinary General Meeting of Shareholders of TGC-1 approved an additional issue of shares for the purpose of the merger with OJSC "TGC-1 Holding" (see note 14.1)

Shares representing an interest of 28,69% in the group owned by RAO UES of Russia were acquired by the OJSC Gazprom on 23 June 2008.

Currently, the Group operates 55 power plants and its principal activity is electricity and heat generation.

The Group's generating assets are located in the North-West of Russia, in particular, St. Petersburg, Leningrad region, Murmansk region and Karelia. The Company's registered office is located at 1, Marsovo pole, 191186, Saint-Petersburg, Russia.

1.2 Operating environment

Russia continues economic reforms and development of its legal, tax and regulatory frameworks as required by a market economy. The future stability of the Russian economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government.

The Russian economy is vulnerable to market downturns and economic slowdowns elsewhere in the world. The ongoing global financial crisis has resulted in capital markets instability, significant deterioration of liquidity in the banking sector, and tighter credit conditions within Russia. While the Russian Government has introduced a range of stabilization measures aimed at providing liquidity and supporting debt refinancing for Russian banks and companies, there continues to be uncertainty regarding the access to capital and cost of capital for the Group and its counterparties, which could affect the Group's financial position, results of operations and business prospects. Also, the borrowers of the Group may have been affected by the deterioration in liquidity, which could in turn impact their ability to repay the amounts due to the Group.

Note 1. General Information (Continued)

While management believes it is taking appropriate measures to support the sustainability of the Group's business in the current circumstances, unexpected further deterioration in the areas described above could negatively affect the Group's results and financial position in a manner not currently determinable.

1.3 Relations with the State and current regulation

As at 31 December 2007, the Russian government owned over 50% of the voting shares in RAO UES. In its turn, RAO UES owned 42.31% of the voting shares of the Company. Therefore, the Group was under significant influence of Russian government as at 31 December 2007.

As at 31 December 2008 OJSC Gazprom owned 28,66% of the voting shares of the Company. Other significant shareholders as at 31 December 2008 were Fortum Power and Heat Oy (25.7%), LLC Russian Energy Projects (17,67%) and HC Interros (5.6%).

The Group's customer base also includes a large number of entities controlled by, or related to the State. Furthermore, the State controls a number of the Group's fuel and other suppliers.

The government of the Russian Federation directly affects the Group's operations through regulation by the Federal Service on Tariffs ("FST"), with respect to its wholesale energy purchases, and by the St. Petersburg and Leningrad Oblast Regional Services on Tariffs ("RSTs"), with respect to its retail electricity and heat sales. The operations of all generating facilities are coordinated by OAO System Operator of Unified Energy System. System Operator is controlled by Russian Federation.

Tariffs which the Group may charge for sales of electricity and heat are governed by regulations specific to the electricity and heat industry and by regulations applicable to natural monopolies. Historically, such tariffs have been based on a "cost-plus" system, meaning cost of service plus a margin, where costs are determined based on the information taken from the Regulations on Accounting and Reporting of the Russian Federation, a basis of accounting which significantly differs from International Financial Reporting Standards.

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

1.4 Regulatory issues and sector restructuring

Following Russian electric utility sector restructuring aimed to introduce competition to electricity (capacity) market, the New Wholesale Electric Power (capacity) Market Rules of the Transitional period (the "NOREM") approved by Resolution of the Government of the Russian Federation No. 529 dated 31 August 2006 were adopted. Under the new wholesale market framework, electricity and power purchase-sales transactions in the regulated market sector are to be governed by a regulated bilateral contract system. Starting from 1 September 2006 regulated contracts covered all volumes of electricity and power produced and consumed.

Starting 2007 the volumes of electricity and power traded in the wholesale market applying regulated prices are substantially reducing, pursuant to Russian Federation Government Resolution No. 205 dated 7 April 2007 "On amending certain resolutions of the Russian Federation Government related to the calculation of electricity volumes sold at free (competitive) prices". The Resolution states that electricity and power supplied at regulated prices will gradually decrease.

The period from 2006 to 2011 is considered as a transitional period. Upon the termination of the transitional period the organization of a competitive electricity wholesale competitive market will be completed.

Electricity volumes produced, not covered by the regulated contracts, are traded at unregulated prices on the basis of free bilateral contracts or on a day-ahead market. Under free bilateral contracts market participants have the right to choose contracting parties, prices and volumes. The day-ahead market is based on the competitive selection of bids submitted by suppliers and buyers the day before the electricity is supplied.

On 30 June 2008 a Resolution of the Russian Government was issued on the launch of the capacity market where available capacity volumes will be allowed to be traded at transition auctions providing for supplies during 2009-2011 and long-term auctions for 10 years supplies, provided they pass through the competitive selection procedure in their respective free power flow zone. For the first time, the wholesale market agents will have the possibility to conclude non-regulated contracts for capacity supply.

Note 1. General Information (Continued)

1.5 Going concern

The financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities in the normal course of business.

The future operations of the Group may be significantly affected by the current and future economic environment and the Group's financial condition.

Recent volatility in global and Russian financial markets. The ongoing global liquidity crisis which commenced in the middle of 2007 has resulted in, among other things, a lower level of capital market funding, lower liquidity levels across the Russian banking sector, and higher interbank lending rates. The uncertainties in the global financial market have also led to bank failures and bank rescues in the United States of America, Western Europe and in Russia. Such circumstances could affect the ability of the Group to obtain new borrowings and re-finance its existing borrowings at terms and conditions similar to those applied to earlier transactions. The debtors (borrowers) of the Group may also be affected by the lower liquidity situation which could in turn impact their ability to repay their amounts owed. Deteriorating operating conditions for debtors (borrowers) may also have an impact on Management's cash flow forecasts and assessment of the impairment of financial and non-financial assets. To the extent that information is available, Management has reflected revised estimates of expected future cash flows in its impairment assessments.

The uncertainty in the global markets combined with other local factors has during 2008 led to very high volatility in the Russian stock markets and at times much higher than normal interbank lending rates.

Management is unable to reliably estimate the effects on the Group's financial position of any further deterioration in the liquidity of the financial markets and the increased volatility in the currency and equity markets. Management believes it is taking all the necessary measures to support the sustainability and growth of the Group's business in the current circumstances.

Current liabilities of the Group are higher than current assets as at 31 December 2008. The management believes that the Group will be able to continue operation on a going concern basis due to the following facts:

- Demand for electricity has shown a long term trend of growth;
- The expected discounted future cash flows significantly exceed the Group's net book value of property, plant and equipment;
- The Group does not expect to reduce its production volumes;
- The Group is not planning to sell significant part of the assets;
- The Group was included in the list 300 of Companies which will receive the support from the government in case of financial problems.

Therefore the accompanying financial statements do not include any adjustments that might be necessary should the Group be unable to continue as a going concern.

Note 2. Summary of Significant Accounting Policies

2.1 Basis of preparation

Statement of compliance

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) under the historical cost convention except as described below. The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated.

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

(in thousands of Russian Roubles, except per share amounts)

Note 2. Summary of Significant Accounting Policies (Continued)

Changes in presentation of Property, plant and equipment

Management amended the allocation of net book value between the groups (types of facility) of property, plant and equipment recorded as at 31 December 2007. Furthermore the VAT on prepayments under capital construction was excluded from construction in progress value.The effect of these changes in preparing the financial statement for the year ended 31 December 2008 on the opening balance of net book values of property, plant and equipment by type of facility is as follows:

Net book values:	As previously reported as at 31 December 2007	Effect of the reclassification	Effect of the VAT on prepayments excluding	Restated as at 31 December 2007
Production buildings	8 670 287	(647)	-	8 669 640
Hydrotechnical buildings	10 866 711	31 636	-	10 898 347
Generating equipment	5 265 593	(1 138 975)	-	4 126 618
Heating networks	4 910 518	1 144 661	-	6 055 179
Construction in progress	11 879 967	-	(933 795)	10 946 172
Other	3 380 252	(36 675)	-	3 343 577
Property, Plant and Equipment, Total	**44 973 328**	**-**	**(933 795)**	**44 039 533**
Other non-current assets, Total			**349 503**	
Accounts receivable and prepayments, Total	**44 973 328**	**-**	**584 292**	**44 039 533**

Functional and presentation currency

The national currency of the Russian Federation is the Russian Rouble ("RUB"), which is the functional currency of each of the entity of the Group and the currency in which these consolidated financial statements are presented.

Accounting for the effects of hyperinflation

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

2.2 Principles of consolidation

The consolidated financial statements comprise the financial statements of the Company and the financial statements of those entities, in which the Company has control. Control is presumed to exist when the Company has the right to control entities directly or indirectly through subsidiaries.

Subsidiaries are those companies and other entities (including special purpose entities) in which the Company, directly or indirectly, has an interest of more than one half of the voting rights or otherwise has power to govern the financial and operating policies so as to obtain economic benefits. The existence and effect of potential voting rights that are presently exercisable or presently convertible are considered when assessing whether the Company controls another entity. Subsidiaries are consolidated from the date on which control is transferred to the Group (acquisition date) and are deconsolidated from the date that control ceases.

Intercompany transactions, balances and unrealised gains on transactions between group companies are eliminated; unrealised losses are also eliminated unless the cost cannot be recovered. The Company and its subsidiary use uniform accounting policies consistent with the Group's policies.

Minority interest is that part of the net results and of the net assets of a subsidiary attributable to interests which are not owned, directly or indirectly, by the Company. The minority interest forms a separate component of the Group's equity.

Note 2. Summary of Significant Accounting Policies (Continued)

2.3 Transfers of subsidiaries from parties under common control

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

2.4 Foreign currency

Monetary assets and liabilities, which are held by the Group entities and denominated in foreign currencies at the balance sheet date, are translated into Russian Roubles at the official exchange rates of the Central Bank of the Russian Federation prevailing at the respective balance sheet date. Foreign currency transactions are accounted for at the exchange rates prevailing at the date of the transaction. Gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement. Translation at year-end rates does not apply to non-monetary items, that are measured at historical costs.

As at 31 December 2008, the official rate of exchange, as determined by the Central Bank of the Russian Federation, between the Russian Rouble and the US Dollar ("USD") was RUB 29.3804: USD 1 (31 December 2007 - RUB 24.5462: USD 1), between the Russian Rouble and Euro: RUB 41.4411: EUR 1 (31 December 2007 - RUB 35.9332: EUR 1).

As at the balance sheet date, exchange restrictions and currency controls existed relating to converting the Russian Rouble into other currencies. The Russian Rouble is not freely convertible in most countries outside of the Russian Federation.

2.5 Property, plant and equipment

Property, plant and equipment are stated at cost, restated to the equivalent purchasing power of the Russian Rouble at 31 December 2002 for assets acquired prior to 1 January 2003 (see Note 2.1), less accumulated depreciation and provision for impairment, where required. Cost includes borrowing costs incurred on specific or general funds borrowed to finance construction of qualifying assets.

At the time of the Group's foundation in 2005 property, plant and equipment were recorded at the carrying values determined in accordance with the IFRS at the date of their transfer to the Group by the Predecessor (RAO UES).

At each reporting date management assesses whether there is any indication of impairment of property, plant and equipment. If any such indication exists, management estimates the recoverable amount which is determined as the higher of an asset's fair value less costs to sell and its value in use. The carrying amount is reduced to the recoverable amount and the difference is recognised as an expense (impairment loss) in the income statement. An impairment loss recognised in prior periods is reversed if there has been a positive change in the estimates used to determine an asset's recoverable amount.

Costs of minor repairs and maintenance are expensed when incurred. Cost of replacing major parts or components of property, plant and equipment items are capitalised and the replaced part is retired. Gains and losses arising from disposal of property, plant and equipment are included in the income statement.

Social assets are not capitalised as they are not expected to result in future economic benefits to the Group. Costs associated with fulfilling the Group's social responsibilities are expensed as incurred.

Depreciation of property, plant and equipment is calculated on a straight-line basis over the estimated useful life of the asset when it is available for use. Depreciation commences on the date of acquisition, or in respect of internally constructed assets, from the time the asset is completed and ready for use.

(in thousands of Russian Roubles, except per share amounts)

Note 2. Summary of Significant Accounting Policies (Continued)

The estimated useful lives, in years, of assets by type of facility are as follows:

Type of facility	Acquired prior to 1 January 2007*	Acquired subsequent to 1 January 2007
Production buildings	4-50	50
Hydrotechnical buildings	3-50	50
Generating equipment	6-30	20-30
Heating networks	3-20	20
Other	3-25	10-25

* *remaining useful lives as at the date of assessment*

The residual value of an asset is the estimated amount that the Group would currently obtain from disposal of the asset less the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

2.6 Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks, and other short-term highly liquid investments with original maturities of three months or less. Cash and cash equivalents are carried at amortised cost using the effective interest method.

2.7 Inventories

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

2.8 Value added tax on purchases and sales

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

Long-term input VAT is recognised upon initial recognition at nominal amount. Any IAS36 type impairment indicator, which would include a delay in cashflows beyond those initial expected, would result in impairment. The impairment would be the difference between carrying amount (nominal) and the present value of the latest expected cashflows.

2.9 Accounts receivable

Accounts receivable are recorded inclusive of VAT. Trade receivables are recognised initially at fair value and subsequently measured at amortized cost using the effective interest rate method less provision for impairment. Such a provision for impairment of accounts receivable is established if there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables. The amount of the provision is the difference between the carrying amount and the recoverable amount, being the present value of expected cash flows, discounted at the original effective interest rate. The carrying amount of the asset is reduced through the use of provision for impairment account. When a trade receivable is uncollectible, it is written off against the provision for impairment of trade receivables. Subsequent recoveries of amounts previously written off are credited against operating costs in the income statement. The primary factors that the Group considers whether a receivable is impaired is its overdue status and realisability of related collateral, if any. The following are the other principal criteria used to determine whether there is objective evidence that an impairment loss has occurred:

Note 2. Summary of Significant Accounting Policies (Continued)

- any portion of the receivable is overdue and the late payment cannot be attributed to a delay caused by the settlement systems;
- the counterparty experiences a significant financial difficulty as evidenced in the financial information that the Group obtains;
- the counterparty undergoes bankruptcy or a financial reorganisation;
- there is an adverse change in the payment status of the counterparty as a result of changes in the national or local economic conditions that impact the counterparty;
- the value of collateral, if any, significantly decreases as a result of deteriorating market conditions.

2.10 Prepayments

Prepayments are carried at cost less any provision for impairment. A prepayment is classified as non-current when the goods or services relating to the prepayment are expected to be obtained after more than one year, or when the prepayment relates to an asset which will itself be classified as non-current upon initial recognition. Prepayments to acquire assets are transferred to the carrying amount of the asset once the Group has obtained control of the asset and it is probable that future economic benefits associated with the asset will flow to the Group. Other prepayments are written off to profit or loss when the goods or services relating to the prepayments are received. If there is an indication that the assets, goods or services relating to a prepayment will not be received, the carrying value of the prepayment is written down accordingly and a corresponding impairment loss is recognised in profit or loss.

2.11 Classification, recognition and measurement of financial assets

The Group classifies its financial assets into the following measurement categories available-for-sale and loans and receivables.

Loans and receivables are unquoted non-derivative financial assets with fixed or determinable payments other than those that the Group intends to sell in the near term.

All other financial assets are included in the available-for-sale category. Available-for-sale investments are carried at fair value. Dividends on available-for-sale equity instruments are recognised in profit or loss when the Group's right to receive payment is established. All other elements of changes in the fair value are deferred in equity until the investment is derecognised or impaired at which time the cumulative gain or loss is transferred from equity to profit or loss.

Impairment losses for available-for-sale investments are recognised in profit or loss when incurred as a result of one or more events ("loss events") that occurred after the initial recognition of available-for-sale investments. A significant or prolonged decline in the fair value of an equity security below its cost is an indicator that it is impaired. The cumulative impairment loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that asset previously recognised in profit or loss – is removed from equity and recognised in profit or loss. Impairment losses on equity instruments are not reversed through profit or loss. If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through current period's profit or loss.

2.12 Classification of financial liabilities

The Group classifies its financial liabilities into other financial liabilities which are carried at amortised cost.

2.13 Initial recognition of financial instruments

Trading investments, derivatives and other financial instruments at fair value through profit or loss are initially recorded at fair value. All other financial assets and liabilities are initially recorded at fair value plus transaction costs. Fair value at initial recognition is best evidenced by the transaction price. A gain or loss on initial recognition is only recorded if there is a difference between fair value and transaction price which can be evidenced by other observable current market transactions in the same instrument or by a valuation technique whose inputs include only data from observable markets.

Note 2. Summary of Significant Accounting Policies (Continued)

All purchases and sales of financial assets that require delivery within the time frame established by regulation or market convention ("regular way" purchases and sales) are recorded at trade date, which is the date that the Group commits to deliver a financial asset. All other purchases are recognised when the entity becomes a party to the contractual provisions of the instrument.

2.14 Derecognition of financial assets

The Group derecognises financial assets when (a) the assets are redeemed or the rights to cash flows from the assets otherwise expired or (b) the Group has transferred the rights to the cash flows from the financial assets or entered into a qualifying pass-through arrangement while (i) also transferring substantially all the risks and rewards of ownership of the assets or (ii) neither transferring nor retaining substantially all risks and rewards of ownership but not retaining control. Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without needing to impose additional restrictions on the sale.

2.15 Accounts payable and accrued liabilities

Accounts payable are stated inclusive of VAT. Trade payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest rate method.

2.16 Borrowings

Borrowings are carried at amortised cost using the effective interest method. Interest costs on borrowings to finance the construction of property, plant and equipment are capitalised during the period of time that is required to complete and prepare the asset for its intended use. All other borrowing costs are expensed.

2.17 Government grants

Grants from the government are recognised at their fair value where there is a reasonable assurance that the grant will be received and the Group will comply with all attached conditions. Government grants relating to the purchase of property, plant and equipment are included in non-current liabilities as deferred income and are credited to the income statement on a straight line basis over the expected lives of the related assets.

Government grants relating to costs are deferred and recognised in the income statement over the period necessary to match them with the costs that they are intended to compensate.

2.18 Minority interest

Minority interest represents the minority shareholders' proportionate share of the equity and results of operations of the Company's subsidiaries. This has been calculated based upon the minority interests' ownership percentage of these subsidiaries. In purchases of minority interest, difference, if any, between the carrying amount of a minority interest and the amount paid to acquire it is recorded directly in equity.

2.19 Provisions for liabilities and charges

Provisions for liabilities and charges are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made. Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Where the Group expects a provision to be reimbursed, for example, under an insurance contract, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

2.20 Pension and post-employment benefits

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

Note 2. Summary of Significant Accounting Policies (Continued)

The Group also operates defined benefit plans. In respect of some of these plans the Group has a contract with a non-governmental pension fund, whilst the other plans are operated by the Group without engaging pension funds.

Cash paid by the Group to the solidarity account with the non-governmental pension fund is refundable to the Group until it is allocated to individual pensioners' bank accounts, and, on that basis, is accounted for by the Group as an asset (accounts receivable from the pension fund).

Defined benefit plans determine the amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and compensation. The liability recognised in the balance sheet in respect of defined benefit pension plans operated by the Group is the present value of the defined benefit obligation at the balance sheet date, together with adjustments for unrecognised actuarial gains or losses and past service cost. All defined benefit plans are considered to be fully unfunded. The defined benefit obligations are calculated using the projected unit credit method. The present value of the defined benefit obligations is determined by discounting the estimated future cash outflows using interest rates of government bonds that are denominated in the currency in which the benefits associated with the operations of the plan will be paid, and that have terms to maturity approximating the terms of the related post-employment benefits.

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

2.21 Income tax

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

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

Provisions for undeclared taxes, and related interest and penalties, are recognised when the Group has a present legal obligation, and a reliable estimate of the amount can be made. A provision is recognised for undeclared taxes and interest when they become payable according to law. The provisions are maintained, and updated if necessary, for the period over which the respective tax positions remain subject to review by the tax and customs authorities, being 3 years from the year of filing. Upon expiry of the review period, the provisions are released and disclosed as a contingent liability until the accounting documentation maintenance period expires, being an additional 2 years (ie 5 years in total).

Liabilities for undeclared taxes, interest and penalties are calculated based on management's best estimate of the obligations, in accordance with rates set out in the respective laws in effect at the balance sheet date.

The Group's uncertain tax positions are reassessed by management at every balance sheet date. Liabilities are recorded for income tax positions that are determined by management as more likely than not to result in additional taxes being levied if the positions were to be challenged by the tax authorities. The assessment is based on the interpretation of tax laws that have been enacted or substantively enacted by the balance sheet date and any known court or other rulings on such issues. Liabilities for penalties, interest and taxes other than on income are recognised based on management's best estimate of the expenditure required to settle the obligations at the balance sheet date.

Note 2. Summary of Significant Accounting Policies (Continued)

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

Deferred tax is not provided for the undistributed earnings of the subsidiary, as the Group requires profits to be reinvested, and only insignificant dividends are expected to be declared from future profits of the subsidiary. Neither these future profits nor the related taxes are recognised in these consolidated financial statements.

2.22 Revenue recognition

Revenue is recognised on the delivery of electricity and heat and on the dispatch of non-utility goods and services during the period. Revenue amounts are presented exclusive of VAT. Revenues are measured at the fair value of the consideration received or receivable.

2.23 Operating lease

Where the Group is a lessee in a lease which does not transfer substantially all the risks and rewards incidental to ownership from the lessor to the Group, the total lease payments are charged to income statement on a straight-line basis over the period of the lease. The lease term is the non-cancellable period for which the lessee has contracted to lease the asset together with any further terms for which the lessee has the option to continue to lease the asset, with or without further payment, when at the inception of the lease it is reasonably certain that the lessee will exercise the option.

2.24 Equity

Share capital. Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction, net of tax, from the proceeds. Any excess of the fair value of consideration received over the par value of shares issued is recorded in equity as share premium.

Merger reserve. Any difference between the carrying value of the net assets merged into the Group as a result of a transaction under common control, and the nominal value of any shares issued is recorded in equity, as a merger reserve.

Treasury shares. Where the Company purchases its equity share capital, the consideration paid, including any directly attributable incremental costs (net of income taxes), is deducted from equity attributable to the Company's equity holders until the shares are cancelled, reissued or disposed of. Where such shares are subsequently sold or reissued, any consideration received, net of any directly attributable incremental transaction costs and the related income tax effects, is included in equity attributable to the Company's equity holders.

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

2.25 Environmental liabilities

Liabilities for environmental remediation are recorded where there is a present obligation, the payment is probable and reliable estimates can be made.

2.26 Earnings per share

Earnings per share are determined by dividing the profit attributable to ordinary shareholders of the Parent by the weighted average number of ordinary shares outstanding during the reporting period.

Note 2. Summary of Significant Accounting Policies (Continued)

2.27 Segment reporting

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

2.28 Seasonality

Demand for electricity and heat is influenced by both the seasons of the year and the relative severity of the weather. Revenues from sales of heat are concentrated within the months of October to March. A similar, although less intense, concentration of electricity sales occurs within the same period. The seasonality of electricity and heat production has a corresponding impact on the usage of fuel and the purchase of power.

Furthermore, during the periods of lower production from April to September, there is an increase in the expenditures on repairs and maintenance. This seasonality does not impact the revenue or cost recognition policies of the Group.

2.29 Interest

Interest income and expense are recognised in the income statement for all interest bearing instruments on an accrual basis using the effective interest rate method. Interest income includes nominal interest and accrued discount and premium.

2.30 Adoption of new or revised standards and interpretations

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

- ***IFRIC 11, IFRS 2—Group and Treasury Share Transactions*** (effective for annual periods beginning on or after 1 March 2007);
- ***IFRIC 12, Service Concession Arrangements*** (effective for annual periods beginning on or after 1 January 2008); and
- ***IFRIC 14, IAS 19—The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*** (effective for annual periods beginning on or after 1 January 2008).

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

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

Note 3. Critical Accounting Estimates and Judgements in Applying Accounting Policies

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

(in thousands of Russian Roubles, except per share amounts)

Note 3. Critical Accounting Estimates and Judgements in Applying Accounting Policies (Continued)

Provision for impairment of property, plant and equipment

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

In determining whether previously recognised impairment loss should be partially reversed, Management considered the recent positive changes in it's operations, in particular improved efficiency of generating equipment due to significant additions to property, plant and equipment in 2007 and 2008, and increasing share of sales at the non-regulated electricity market (see also Note 1.4). Considering these factors, management reassessed the recoverable amount of the Group's property, plant and equipment as at 31 December 2008. As a result, management believes that provision for impairment of property, plant and equipment previously recorded by the Group in respect of certain electricity and heat generating assets should be partially reversed as at 31 December 2008. The amount of reversal was estimated by management as RUB 1 456 683 thousand. The future tariff estimates used by management in forecasting the future cash flows are based on the Scenario of Economic Performance of the Russian Federation and the Key Parameters of Forecasting Social and Economic Development of the Russian Federation for 2009 and the 2010-2011 Planning Period, approved by the Ministry of Economic Development of the Russian Federation in May 2008.The impairment loss related to the Thermal Power Plants (further "TPP") of Nevsky branch and Apatitskaya TPP was reversed in the amount of RUB 1 456 683 thousand. Similary, management recognised a further impairment loss in respect of the property, plant and equipment of Heating Network of Nevsky branch in the amount of RUB 277 234 thousand (see also Note 6).

Management made the following significant assumptions when estimating the value in use of property, plant and equipment and determining the levels of impairment provisions as at 31 December 2008:

- average remaining useful lives have been estimated by management for each separate cash generating units on the basis of a report by a consortium of independent appraisers as at 31 December 2006 and taking into account the latest capital investment programme of the Group, as follows:

Name of cash generating unit	Average remaining useful lives, years
Kolsky branch (HPS)	12
Karelsky branch (HPS)	12
Apatitskaya Thermal Power Plant (TPP)	5
HPS of Nevsky branch	15
TPP of Nevsky branch	12
Heating Network of Nevsky branch	14
Murmanskaya TPP	10

- increase in average selling price for electricity is 21% for 2009; further expected increase of average selling price for electricity is estimated by the management as 21%-31% p.a. in 2010-2011 and 3%-11% p.a. in 2012 and onwards; increase in average selling price for electricity for Murmanskaya TPP is 13% for 2009; further expected increase of average selling price for electricity is estimated as 14%-17% p.a. in 2010-2011 and 3%-5% p.a. in 2012 and onwards;
- increase in average selling price for heat is 20% for 2009 for all of the Group's cash generating units except for Murmanskaya TPP; further expected increase of average selling price for heat is estimated by the management as 23%-24% p.a. in 2010-2011 and 4%-8% p.a. in 2012 and onwards. The average selling price for heat at Murmanskaya TPP is expected to increase by 18% p.a. in 2010-2011 and 2%-6% p. a. in 2012 and onwards;
- expected increase in fuel prices was estimated by management as 13% p.a. for coal at Apatitskaya TPP and 24% p.a. for gas at TPP of Nevsky branch on average in 2009-2011; 7% p.a. for coal at Apatitskaya TPP and 8% p.a. for gas at TPP of Nevsky branch in 2012 and onwards;
- increase in fuel oil price for Murmanskaya TPP is 1% for 2009; further expected increase in fuel oil price is estimated by the management as 20% in 2010 and 3%-5% p.a. in 2012 and onwards

Note 3. Critical Accounting Estimates and Judgements in Applying Accounting Policies (Continued)

- production volumes of electricity and heat for cash generating units were estimated by management as follows: it is expected decrease by 16% for Karellsky branch electricity volume, decrease by 2%-5% for HPS and TPP of Nevsky branch electricity volume, Karelsky branch heat volume and Apatitskaya TPP electricity and heat volume for 2009; increase by 3%-9% for Karelsky branch electricity volume, for Apatitskaya TPP heat volume and Karelsky branch heat volume and decrease for HPS of Nevsky branch electricity volume by 7%-14% in 2010-2011; management expects current level for Kolsky branch electricity volume and Karelsky branch heat volume, decrease by 2%-11% for HPS Nevsky branch electricity volume, general increase by 1%-2% for other cash generating units except Apatitskaya TPP for 2012 and onwards. Increase in production volumes of electricity and heat for Apatitskaya TPP is estimated by the management as 67% of electricity volume and as 61% of heat volume in 2012.
- increase in tariffs for Heating Network of Nevsky Branch complies with inflation rate;
- repair and maintenance expenses of Heating Network of Nevsky Branch were estimated on the basis of repair cost per 1 km of pipelines (RUB 57 222 thousand)of heating networks requiring repairs on an annual basis;
- weighted average cost of capital of 15.63% was applied for discounting future operating cash flows generated by the Group from all cash generating units.

Variations in the above assumptions may give rise to a significantly different amount for the impairment provision. In particular:

- Should the annual growth rate of the selling price for electricity and heat be increased/decreased by 10% then an estimate of the recoverable amount would result in a decrease/increase in the impairment provision of RUB (5 256 381)/9 402 836 thousand as at 31 December 2008;
- Should the annual growth rate of the operating expenses, including fuel costs, be increased/decreased by 10% then an estimate of the recoverable amount would result in an increase/decrease in the impairment provision of RUB 9 594 385/(5 186 941) thousand as at 31 December 2008;
- Should the remaining useful economic lives of property, plant and equipment be increased/ decreased by 10%, then an estimate of the recoverable amount would result in a decrease/ increase in the impairment provision of RUB (3 015 440)/2 359 054 thousand as at 31 December 2008;
- Should the weighted average cost of capital be increased/decreased by 10%, then an estimate of the recoverable amount would result in an increase/decrease in the impairment provision of RUB 2 096 385/(2 397 476) thousand as at 31 December 2008.

In management's opinion, the existing provision represents the best estimate of the impact of impairment as a result of the current economic conditions affecting the Group.

As at 31 December 2007, management also considered recent changes in operation of the Russian electricity market (see also Note 1.4) and reassessed the recoverable amount of the Group's property, plant and equipment as at 31 December 2007. As a result, management concluded that provision for impairment of property, plant and equipment previously recorded by the Group in respect of electricity and heat generating assets should be partially reversed as at 31 December 2007. The amount of reversal was estimated by management as RUB 3 824 248 thousand. The future tariff estimates used by management in forecasting future cash flows were based on the Scenario of Economic Performance of the Russian Federation and the Key Parameters of Forecasting Social and Economic Development of the Russian Federation for 2009 and the 2010-2011 Planning Period, approved by the Ministry of Economic Development of the Russian Federation in May 2008. The increased forecasted tariffs had the most significant positive impact on the projected cash flows of hydro-electric power stations of Nevsky branch and Heating Networks, where the increased revenue forecast were not offset by the corresponding fuel cost increases, so there has been a release of impairment provision related to the HPS of Nevsky branch and Heating Networks of RUB 1 049 853 thousand and RUB 1 905 382 thousand respectively. On the other hand, management recognised a further impairment loss in respect of the property, plant and equipment of TPP of Nevsky Branch in the amount of RUB 55 501 thousand (see also Note 6).

(in thousands of Russian Roubles, except per share amounts)

Note 3. Critical Accounting Estimates and Judgements in Applying Accounting Policies (Continued)

Management made the following significant assumptions when estimating the value in use of property, plant and equipment and determining the levels of impairment provisions as at 31 December 2007:

- average remaining useful lives have been estimated by management for separate cash generating units on the basis of a report by a consortium of independent appraisers as at 31 December 2006 and taking into account the latest capital investment programme of the Group, as follows:

Name of cash generating unit	Average remaining useful lives, years
Kolsky branch (HPS)	12
Karelsky branch (HPS)	13
Apatitskaya Thermal Power Plant (TPP)	7
HPS of Nevsky branch	13
TPP of Nevsky branch	10
Heating Network of Nevsky branch	10
Murmanskaya TPP	4

- increase in average selling price for electricity is 17% for 2008; further expected increase of average selling price for electricity is estimated by the management as 19%-24% p.a. in 2009-2011 and 9%-11% p.a. in 2012 and onwards;
- increase in average selling price for heat is 18% for 2008 for all of the Group's cash generating units except for Murmanskaya TPP; further expected increase of average selling price for heat is estimated by the management as 18%-23% p.a. in 2009-2011 and 7% p.a. in 2012 and onwards. The average selling price for heat at Murmanskaya TPP is expected to increase by 16% p.a. in 2008-2011;
- expected increase in fuel prices was estimated by management as 12% p.a. for coal at Apatitskaya TPP and 28% p.a. for gas at TPP of Nevsky branch on average in 2008-2011; 6% p.a. for coal at Apatitskaya TPP and 8% p.a. for gas at TPP of Nevsky branch in 2012 and onwards;
- production volumes of electricity will remain at the current level for Karelsky branch, Kolsky branch and HPS of Nevsky branch. For other cash generating units, management expects increases in heat and electricity volumes within the range of 1% to 10% over the period of the forecast. This increase is applied to the existing production capacity (investment programme is not included);
- for the cash generating unit Heating Network of Nevsky Branch the increase in tariffs for heat transportation was estimated in proportion to the heat tariffs increase;
- repair and maintenance expenses of Heating Network of Nevsky Branch were estimated on the basis of repair cost per 1 km of pipelines (RUB 49 890 thousand) applied to 40 km of heating networks requiring repairs on an annual basis. The total length of heat pipelines for Heating Network of Nevsky branch is approximately 800 km;
- weighted average cost of capital of 10.23% was applied for discounting future operating cash flows generated by the Group from all cash generating units.

Useful lives of property, plant and equipment

The estimation of the useful life of an item of property, plant and equipment is a matter of management's judgement based upon experience with similar assets. In determining the useful life of an asset, management considers the expected usage, estimated technical obsolescence, physical wear and tear and the physical environment in which the asset is operated. Changes in any of these conditions or estimates may result in adjustments for future depreciation rates.

Recoverability of accounts receivable

Provision for impairment of accounts receivable is based on the Group's assessment of whether the collectibility of specific customer accounts worsened compared to previous period estimates. If there is a deterioration in a major customer's creditworthiness or actual defaults are higher than the estimates, the actual results could differ from these estimates (see also Note 25).

Tax legislation

Russian tax, currency and customs legislation is subject to varying interpretations (Note 24).

(in thousands of Russian Roubles, except per share amounts)

Note 3. Critical Accounting Estimates and Judgements in Applying Accounting Policies (Continued)

Pension obligation

The principal actuarial assumptions used to calculate the defined benefit obligation as at 31 December 2008 are listed in Note 16. The impact of potential changes in these assumptions is as follows:

	Increase in the present value of the defined benefit obligation as at 31 December 2008
Discount rate lower by 0.75 % p.a.	7%
Salary rate increase of 0.75% p.a.	1%
Inflation (pension rate) increase of 0.75% p.a.	6%
Withdrawal rate lower by 1.5% p.a.	6%

The principal actuarial assumptions used to calculate the defined benefit obligation as at 31 December 2007 are listed in Note 16. The impact of potential changes in these assumptions is as follows:

	Increase in the present value of the defined benefit obligation as at 31 December 2007
Discount rate lower by 0.75 % p.a.	8%
Salary rate increase of 0.75% p.a.	1%
Inflation (pension rate) increase of 0.75% p.a.	7%
Withdrawal rate lower by 1.5% p.a.	3%

Note 4. New Accounting Pronouncements

Certain new standards and interpretations have been published that are mandatory for the Group's accounting periods beginning on or after 1 January 2009 or later periods and which the Group has not early adopted:

IFRS 8, Operating Segments (effective for annual periods beginning on or after 1 January 2009). The standard applies to entities whose debt or equity instruments are traded in a public market or that file, or are in the process of filing, their financial statements with a regulatory organisation for the purpose of issuing any class of instruments in a public market. IFRS 8 requires an entity to report financial and descriptive information about its operating segments, with segment information presented on a similar basis to that used for internal reporting purposes. Management is currently assessing what impact the standard will have on segment disclosures in the Group's financial statements.

Puttable financial instruments and obligations arising on liquidation—IAS 32 and IAS 1 Amendment (effective from 1 January 2009). The amendment requires classification as equity of some financial instruments that meet the definition of a financial liability. The Group does not expect the amendment to affect its financial statements.

IAS 1, Presentation of Financial Statements (revised September 2007; effective for annual periods beginning on or after 1 January 2009). The main change in IAS 1 is the replacement of the income statement by a statement of comprehensive income which will also include all non-owner changes in equity, such as the revaluation of available-for-sale financial assets. Alternatively, entities will be allowed to present two statements: a separate income statement and a statement of comprehensive income. The revised IAS 1 also introduces a requirement to present a statement of financial position (balance sheet) at the beginning of the earliest comparative period whenever the entity restates comparatives due to reclassifications, changes in accounting policies, or corrections of errors.

IAS 23, Borrowing Costs (revised March 2007; effective for annual periods beginning on or after 1 January 2009). The revised IAS 23 was issued in March 2007. The revised IAS 23 eliminates the option of expensing all borrowing costs and requires borrowing costs to be capitalized if they are directly attributable to the acquisition, construction or production of a qualifying asset. IAS 23 becomes effective for annual periods beginning on or after January 1, 2009.

According to the accounting policy of the Group borrowing costs that are directly attributable to the construction of a qualifying asset are capitalised as part of the cost of the asset. Therefore, the amendment does not impact the Group's financial statements.

Note 4. New Accounting Pronouncements (Continued)

IAS 27, Consolidated and Separate Financial Statements (revised January 2008; effective for annual periods beginning on or after 1 July 2009). The revised IAS 27 will require an entity to attribute total comprehensive income to the owners of the parent and to the non-controlling interests (previously "minority interests") even if this results in the non-controlling interests having a deficit balance (the current standard requires the excess losses to be allocated to the owners of the parent in most cases). The revised standard specifies that changes in a parent's ownership interest in a subsidiary that do not result in the loss of control must be accounted for as equity transactions. It also specifies how an entity should measure any gain or loss arising on the loss of control of a subsidiary. At the date when control is lost, any investment retained in the former subsidiary will have to be measured at its fair value. The Group does not expect the amendment to affect its financial statements.

IFRS 3, Business Combinations (revised January 2008; effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009). The revised IFRS 3 will allow entities to choose to measure non-controlling interests using the existing IFRS 3 method (proportionate share of the acquired identifiable net assets) or at fair value. The revised IFRS 3 is more detailed in providing guidance on the application of the purchase method to business combinations. The requirement to measure at fair value every asset and liability at each step in a step acquisition for the purposes of calculating a portion of goodwill has been removed. Instead, goodwill will be measured as the difference at acquisition date between the fair value of any investment in the business held before the acquisition, the consideration transferred and the net assets acquired. Acquisition-related costs will be accounted for separately from the business combination and therefore recognised as expenses rather than included in goodwill. An acquirer will have to recognise at the acquisition date a liability for any contingent purchase consideration. Changes in the value of that liability after the acquisition date will be recognised in accordance with other applicable IFRSs, as appropriate, rather than by adjusting goodwill. The revised IFRS 3 brings into its scope business combinations involving only mutual entities and business combinations achieved by contract alone. The Group does not expect the amendment to affect its financial statements.

Vesting Conditions and Cancellations—Amendment to IFRS 2, Share-based Payment (issued in January 2008; effective for annual periods beginning on or after 1 January 2009). The amendment clarifies that only service conditions and performance conditions are vesting conditions. Other features of a share-based payment are not vesting conditions. The amendment specifies that all cancellations, whether by the entity or by other parties, should receive the same accounting treatment. The Group does not expect the amendment to affect its financial statements.

Amendments to IAS 39 Financial instruments: Recognition and measurements (effective from 1 July 2008). An amendment permits an entity to reclassify non – derivative financial assets (other then those designated at fair value through profit or loss by the entity upon initial recognition) out of the fair value through profit or loss category in particular circumstances. The amendment also permits an entity to transfer from the available – for - sale category to the loans and receivables category a financial assets the would have met the definition of loans and receivables (if the financial assets had not been designed as available for sale), if the entity has the intention and ability to hold that financial assets for the foreseeable future. The Group dose not expects these amendments to effect the financial statements.

Amendments to IFRS 7 Financial instruments: Disclosure (effective from 1 July 2008). An amendment requires an entity to make extensive disclosure for any financial asset reclassified in respect of amendments to IAS 39 Financial instruments: Recognition and measurements. The Group dose not expects these amendments to effect the financial statements.

IFRIC 13, Customer Loyalty Programmes (issued in June 2007; effective for annual periods beginning on or after 1 July 2008). IFRIC 13 clarifies that where goods or services are sold together with a customer loyalty incentive (for example, loyalty points or free products), the arrangement is a multiple-element arrangement and the consideration receivable from the customer is allocated between the components of the arrangement using fair values. IFRIC 13 is not relevant to the Group's operations because the Group does not operate any loyalty programmes.

IFRIC 15, Agreements for the Construction of Real Estate (effective for annual periods beginning on or after 1 January 2009). The interpretation applies to the accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors, and provides guidance for determining whether agreements for the construction of real estate are within the scope of IAS 11 or IAS 18. It also provides criteria for determining when entities should recognise revenue on such transactions. The Group does not expect IFRS 15 to affect the financial statements.

Note 4. New Accounting Pronouncements (Continued)

IFRIC 16, Hedges of a Net Investment in a Foreign Operation (effective for annual periods beginning on or after 1 October 2008). The interpretation explains which currency risk exposures are eligible for hedge accounting and states that translation from the functional currency to the presentation currency does not create an exposure to which hedge accounting could be applied. The IFRIC allows the hedging instrument to be held by any entity or entities within a group except the foreign operation that itself is being hedged. The interpretation also clarifies how the gain or loss recycled from the currency translation reserve to profit or loss is calculated on disposal of the hedged foreign operation. Reporting entities will apply IAS 39 to discontinue hedge accounting prospectively when their hedges do not meet the criteria for hedge accounting in IFRIC 16. IFRIC 16 does not have an impact on these financial statements as the Group does not apply hedge accounting.

Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate—IFRS 1 and IAS 27 Amendment (issued in May 2008; effective for annual periods beginning on or after 1 January 2009). The amendment allows first-time adopters of IFRS to measure investments in subsidiaries, jointly controlled entities or associates at fair value or at previous GAAP carrying value as deemed cost in the separate financial statements. The amendment also requires distributions from pre-acquisition net assets of investees to be recognised in profit or loss rather than as a recovery of the investment. The amendments will not have any impact on the Group's consolidated financial statements.

Eligible Hedged Items—Amendment to IAS 39, Financial Instruments: Recognition and Measurement (effective with retrospective application for annual periods beginning on or after 1 July 2009). The amendment clarifies how the principles that determine whether a hedged risk or portion of cash flows is eligible for designation should be applied in particular situations. The amendment is not expected to have any impact on the Group's financial statements as the Group does not apply hedge accounting.

Improvements to International Financial Reporting Standards (issued in May 2008). In 2007, the International Accounting Standards Board decided to initiate an annual improvements project as a method of making necessary, but non-urgent, amendments to IFRS. The amendments issued in May 2008 consist of a mixture of substantive changes, clarifications, and changes in terminology in various standards. The substantive changes relate to the following areas: classification as held for sale under IFRS 5 in case of a loss of control over a subsidiary; possibility of presentation of financial instruments held for trading as non-current under IAS 1; accounting for sale of IAS 16 assets which were previously held for rental and classification of the related cash flows under IAS 7 as cash flows from operating activities; clarification of definition of a curtailment under IAS 19; accounting for below market interest rate government loans in accordance with IAS 20; making the definition of borrowing costs in IAS 23 consistent with the effective interest method; clarification of accounting for subsidiaries held for sale under IAS 27 and IFRS 5; reduction in the disclosure requirements relating to associates and joint ventures under IAS 28 and IAS 31; enhancement of disclosures required by IAS 36; clarification of accounting for advertising costs under IAS 38; amending the definition of the fair value through profit or loss category to be consistent with hedge accounting under IAS 39; introduction of accounting for investment properties under construction in accordance with IAS 40; and reduction in restrictions over manner of determining fair value of biological assets under IAS 41. Further amendments made to IAS 8, 10, 18, 20, 29, 34, 40, 41 and to IFRS 7 represent terminology or editorial changes only, which the IASB believes have no or minimal effect on accounting. The Group does not expect the amendments to have any material effect on its financial statements.

IFRIC 17, Distribution of Non-Cash Assets to Owners (effective for annual periods beginning on or after 1 July 2009). The amendment clarifies when and how distribution of non-cash assets as dividends to the owners should be recognised. An entity should measure a liability to distribute non-cash assets as a dividend to its owners at the fair value of the assets to be distributed. A gain or loss on disposal of the distributed non-cash assets will be recognised in profit or loss when the entity settles the dividend payable. IFRIC 17 is not relevant to the Group's operations because it does not distribute non-cash assets to owners.

IFRS 1, First-time Adoption of International Financial Reporting Standards (following an amendment in December 2008, effective for the first IFRS financial statements for a period beginning on or after 1 July 2009). The revised IFRS 1 retains the substance of its previous version but within a changed structure in order to make it easier for the reader to understand and to better accommodate future changes. The Group concluded that the revised standard does not have any effect on its financial statements.

Note 4. New Accounting Pronouncements (Continued)

IFRIC 18, Transfers of Assets from Customers (effective for annual periods beginning on or after 1 July 2009). The interpretation clarifies the accounting for transfers of assets from customers, namely, the circumstances in which the definition of an asset is met; the recognition of the asset and the measurement of its cost on initial recognition; the identification of the separately identifiable services (one or more services in exchange for the transferred asset); the recognition of revenue, and the accounting for transfers of cash from customers. IFRIC 18 is not expected to have any impact on the Group's financial statements.

Improving Disclosures about Financial Instruments - Amendment to IFRS 7, Financial Instruments: Disclosures (issued in March 2009; effective for annual periods beginning on or after 1 January 2009). The amendment requires enhanced disclosures about fair value measurements and liquidity risk. The entity will be required to disclose an analysis of financial instruments using a three-level fair value measurement hierarchy. The amendment (a) clarifies that the maturity analysis of liabilities should include issued financial guarantee contracts at the maximum amount of the guarantee in the earliest period in which the guarantee could be called; and (b) requires disclosure of remaining contractual maturities of financial derivatives if the contractual maturities are essential for an understanding of the timing of the cash flows. An entity will further have to disclose a maturity analysis of financial assets it holds for managing liquidity risk, if that information is necessary to enable users of its financial statements to evaluate the nature and extent of liquidity risk. The Group is currently assessing the impact of the amendment on disclosures in its financial statements.

Embedded Derivatives - Amendments to IFRIC 9 and IAS 39 (effective for annual periods ending on or after 30 June 2009). The amendments clarify that on reclassification of a financial asset out of the 'at fair value through profit or loss' category, all embedded derivatives have to be assessed and, if necessary, separately accounted for.

Improvements to International Financial Reporting Standards (issued in April 2009; amendments to IFRS 2, IAS 38, IFRIC 9 and IFRIC 16 are effective for annual periods beginning on or after 1 July 2009; amendments to IFRS 5, IFRS 8, IAS 1, IAS 7, IAS 17, IAS 36 and IAS 39 are effective for annual periods beginning on or after 1 January 2010). The improvements consist of a mixture of substantive changes and clarifications in the following standards and interpretations: clarification that contributions of businesses in common control transactions and formation of joint ventures are not within the scope of IFRS 2; clarification of disclosure requirements set by IFRS 5 and other standards for non-current assets (or disposal groups) classified as held for sale or discontinued operations; requiring to report a measure of total assets and liabilities for each reportable segment under IFRS 8 only if such amounts are regularly provided to the chief operating decision maker; amending IAS 1 to allow classification of certain liabilities settled by entity's own equity instruments as non-current; changing IAS 7 such that only expenditures that result in a recognised asset are eligible for classification as investing activities; allowing classification of certain long-term land leases as finance leases under IAS 17 even without transfer of ownership of the land at the end of the lease; providing additional guidance in IAS 18 for determining whether an entity acts as a principal or an agent; clarification in IAS 36 that a cash generating unit shall not be larger than an operating segment before aggregation; supplementing IAS 38 regarding measurement of fair value of intangible assets acquired in a business combination; amending IAS 39 (i) to include in its scope option contracts that could result in business combinations, (ii) to clarify the period of reclassifying gains or losses on cash flow hedging instruments from equity to profit or loss and (iii) to state that a prepayment option is closely related to the host contract if upon exercise the borrower reimburses economic loss of the lender; amending IFRIC 9 to state that embedded derivatives in contracts acquired in common control transactions and formation of joint ventures are not within its scope; and removing the restriction in IFRIC 16 that hedging instruments may not be held by the foreign operation that itself is being hedged. The Group does not expect the amendments to have any material effect on its financial statements.

Unless otherwise described above, the new standards and interpretations are not expected to significantly affect the Group's consolidated financial statements.

Note 5. Related Parties

Related parties are defined in IAS 24, *Related Party Disclosures*. Parties are generally considered to be related if one party has the ability to control the other party, is under common control, or can exercise significant influence or joint control over the other party in making financial and operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

(in thousands of Russian Roubles, except per share amounts)

Note 5. Related Parties (Continued)

Related parties include shareholders that have control or significant influence over the Company, and key management personnel, as well as companies that are controlled by the State.

RAO UES was the main shareholder of the Company as at 31 December 2007 (see Note 1.3). Transactions with RAO UES's subsidiaries are included in balances of state-controlled entities as at 31 December 2007.

During 2008 RAO UES ceased to exist as a related party in respect of OJSC TGC-1 after its reorganisation (see Note 1). Since 23 June 2008 the single largest shareholder of the Group is OJSC Gazprom holding 28,66% of voting shares as at 31 December 2008.

Prior to October 2007 the Group was ultimately controlled by the State of the Russian Federation. The Group was under significant influence of the State as at 31 December 2008 and 2007 and hence all transactions with other state-controlled entities should be disclosed as related party transactions in accordance with IAS 24 requirements.

The nature of the related party relationships for those related parties with whom the Group entered into significant transactions in the years ended 31 December 2008 and 31 December 2007, and had significant balances outstanding at 31 December 2008 and at 31 December 2007 are detailed below.

5.1 OJSC Gazprom and its subsidiaries

Transactions with OJSC Gazprom and its subsidiaries were as follows:

	Year ended 31 December 2008	Year ended 31 December 2007
Fuel	12 675 224	9 153 211
Interest expense	-	22 652
Interest income	(4 013)	-
Total expenses	**12 671 211**	**9 175 863**

Balances with OJSC Gazprom subsidiaries at the end of the period were as follows:

	31 December 2008	31 December 2007
Accounts receivable and prepayments	991 630	622 833
Cash and cash equivalents	1 364 475	3 849
Available-for-sale investments	66 762	-
Other non-current assets	11 070	-
Accounts payable and accrued liabilities	39 506	204 911

5.2 State-controlled entities

In the normal course of business the Group enters into transactions with other entities under Government control. Prices for natural gas, electricity and heat are based on tariffs set by FST and RSTs. Bank loans are obtained at market rates. Taxes are charged and paid under the Russian tax legislation.

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

	Year ended 31 December 2008	Year ended 31 December 2007
Sales of heating	9 224 411	10 732 403
Sales of electricity	12 191 343	13 449 871
Other sales	140 810	107 147
Total sales	**21 556 564**	**24 289 421**
Water usage expenses	1 681 541	1 501 438
Electricity purchases	2 399 565	2 577 832
Heat distribution	1 134 582	985 111
Interest expense	28 027	35 675
Security services	264 818	232 009
Operating lease	219 181	185 517
Railway transportation	13 346	15 672
Interest income	(242 005)	(232 785)
Grants	(331 387)	(136 004)
Other expenses	578 056	575 030
Total expenses	**5 745 724**	**5 739 495**

(in thousands of Russian Roubles, except per share amounts)

Note 5. Related Parties (Continued)

The Group obtained and recognised in income statement a government grant of RR 331 387 thousand (2007: RUB 136 004 thousand) to compensate for losses caused by high fuel oil prices at Murmanskaya TPP incurred in the current year. The Group has no unfulfilled commitments on government grants as at 31 December 2008 and 2007.

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

	31 December 2008	31 December 2007
Cash and cash equivalents	46 945	12 704 239
Accounts receivable and prepayments	2 884 608	3 248 374
Borrowings	1 758 947	253 979
Accounts payable and accrued liabilities	889 150	794 410

5.3 Transactions with other related parties

The Group had the following significant transactions and balances with the shareholder Fortum Power and Heat Oy which has significant influence over Group:

	Year ended 31 December 2008	Year ended 31 December 2007
Sales of electricity	243 805	213 717
Total sales	**243 805**	**213 717**

	31 December 2008	31 December 2007
Accounts receivable and prepayments	49 115	9 937

Transactions and balances with the Non-state pension fund of electrical energy industry are disclosed in Note 16.

5.4 Transactions with the Board of Directors and key management personnel

Total remuneration in the form of salary and bonuses paid to the members of the Board of Directors and key management personnel for the year ended 31 December 2008, was RR 126 521 thousand (2007: RR 142 258 thousand). All remuneration falls under short-term employee benefits definition in IAS 19 "Employee Benefits".

(in thousands of Russian Roubles, except per share amounts)

Note 6. Property, Plant and Equipment

Cost	Production buildings	Hydrotechnical buildings	Generating equipment	Heating networks	Construction in progress	Other	Total
Balance as at 31 December 2007	14 525 011	16 434 963	11 982 406	25 445 937	10 946 172	14 998 352	94 332 841
Additions	13 811	219	373 855	-	20 799 660	503 871	21 691 416
Transfers	288 440	116 544	1 447 245	2 112 862	(4 951 171)	986 080	-
Disposals	(21 387)	(805)	(117 765)	-	(14 765)	(47 589)	(202 311)
Balance as at 31 December 2008	**14 805 875**	**16 550 921**	**13 685 741**	**27 558 799**	**26 779 896**	**16 440 714**	**115 821 946**
Accumulated depreciation (including impairment)							
Balance as at 31 December 2007	(5 855 371)	(5 536 616)	(7 855 788)	(19 390 758)	-	(11 654 775)	(50 293 308)
Charge for the year	(467 212)	(510 980)	(764 856)	(540 007)	-	(467 372)	(2 750 427)
Disposals	11 786	672	84 556	-	-	35 766	132 780
Impairment losses reversed during the year (Note 3)	548 982	15 997	451 321	31 184	-	409 198	1 456 682
Impairment losses (recognised) during the year (Note 3)	(13 856)	-	(2 527)	(255 825)	-	(5 026)	(277 234)
Balance as at 31 December 2008	**(5 775 671)**	**(6 030 927)**	**(8 087 294)**	**(20 155 406)**	**-**	**(11 682 209)**	**(51 731 507)**
Net book value as at 31 December 2007	8 669 640	10 898 347	4 126 618	6 055 179	10 946 172	3 343 577	44 039 533
Net book value as at 31 December 2008	**9 030 204**	**10 519 994**	**5 598 447**	**7 403 393**	**26 779 896**	**4 758 505**	**64 090 439**

Cost	Production buildings	Hydrotechnical buildings	Generating equipment	Heating networks	Construction in progress	Other	Total
Balance as at 31 December 2006	14 431 488	16 425 434	11 416 972	22 625 155	3 232 989	14 279 813	82 411 851
Effect of reclassification (Note 2)	(285)	-	(1 223)	(45 567)	(933 795)	47 075	(933 795)
Additions	22 912	-	32 934	3 586	13 496 657	315 515	13 871 604
Transfers	73 492	9 529	541 457	3 619 488	(4 839 781)	595 815	-
Disposals	(2 596)	-	(7 734)	(756 725)	(9 898)	(239 866)	(1 016 819)
Balance as at 31 December 2007	**14 525 011**	**16 434 963**	**11 982 406**	**25 445 937**	**10 946 172**	**14 998 352**	**94 332 841**
Accumulated depreciation (including impairment)							
Balance as at 31 December 2006	(6 608 623)	(5 498 293)	(7 713 953)	(21 682 719)	-	(11 338 671)	(52 842 259)
Charge for the year	(382 917)	(482 200)	(612 237)	(171 893)	-	(395 574)	(2 044 821)
Disposals	221	-	4 359	708 550	-	111 895	825 025
Impairment losses reversed/ (recognised) during the year (Note 3)	1 136 310	412 241	1 603 795	565 076	-	51 325	3 768 747
Effect of reclassification (Note 2)	(362)	31 636	(1 137 752)	1 190 228	-	(83 750)	-
Balance as at 31 December 2007	**(5 855 371)**	**(5 536 616)**	**(7 855 788)**	**(19 390 758)**	**-**	**(11 654 775)**	**(50 293 308)**
Net book value as at 31 December 2006	7 822 865	10 927 141	3 703 019	942 436	3 232 989	2 941 142	29 569 592
Net book value as at 31 December 2007	**8 669 640**	**10 898 347**	**4 126 618**	**6 055 179**	**10 946 172**	**3 343 577**	**44 039 533**

(in thousands of Russian Roubles, except per share amounts)

Note 6. Property, Plant and Equipment (Continued)

Construction in progress represents the carrying amount of property, plant and equipment that has not yet been made available for use in production, including generating stations under construction.

Other property, plant and equipment includes electricity transmission equipment, motor vehicles, computer equipment, office fixtures and other equipment.

Property, plant and equipment with net book value of RUB 309 029 thousand were pledged as collateral according to loan agreements (31 December 2007: RUB 355 880 thousand) (see Note 15).

Total amount of capitalized interests for the year ended 31 December 2008 is RUB 67 680 thousand (for the year ended 31 December 2007: RUB 278 810 thousand).

Impairment. As described in Note 3, management assessed the recoverability of property, plant and equipment as at 31 December 2008. Value in use was estimated through a review of discounted future cash flows for seven cash-generating units. The significant assumptions applied by management and the results of this impairment assessment are disclosed in Note 3.

Operating lease

The Group leases a number of land plots owned by local governments under operating leases. Land lease commitments are determined by lease agreements and were as follows:

	31 December 2008	31 December 2007
Not later than one year	66 577	51 468
Later than one year and not later than five years	323 821	212 568
Later than five years	1 563 682	1 412 721
Total	**1 954 080**	**1 676 757**

Note 7. Long-term Investments

	% ownership	31 December 2008	31 December 2007
Available-for-sale investments::			
Equity shares in OJSC "Inter RAO UES	0.45%	64 507	-
Equity shares in OJSC "RusHydro"	0.02%	27 182	-
Equity shares in NWTPP	3.06%	-	220 553
Other investments			
Investments in OJSC "Hibinskaya TK"	50.00%	20 000	20 000
Other		160	-
Total investments		**111 849**	**240 553**

On 1 May 2008 OJSC "North-West TPP" was reorganized and merged with OJSC "Inter RAO UES" by converting shares of OJSC "North-West TPP" in to additional ordinary shares of OJSC "Inter RAO UES" and after that OJSC "North-West TPP" ceased to exist anymore. Investment in OJSC "Inter RAO UES" in the Group's consolidated balance sheet as at 31 December 2008 was classified as available-for-sale investment. Investment in OJSC "Inter RAO UES" is traded in active markets and it's fair value was determined by reference to the current market value at the close of business on 31 December 2008.

Also on 1 July 2008 the Company completed the merger with OJSC "TGC -1 Holding" an entity which was spun-off from RAO UES as a new and separate company (see note 1). As a result of the merger with TGC-1 Holding the Company received an investment in the shares of OJSC "Rus Gidro" classified as available-for-sale investment. Shares in OJSC "Rus Gidro" are traded in active markets and their fair value was determined by reference to the current market value at the close of business on 31 December 2008.

Due to current economic situation in Russian Federation a significant decline in the fair value of an available-for-sale investments in OJSC "Inter RAO UES" and OJSC "RusHydro" was indicated by Management for year ended 31 December 2008. According to the accounting policy the cumulative impairment loss in amount RUB 123 105 thousand which was recognised as at 31 December 2007 as a fair value reserve in equity was removed from equity and recognised in the profit or loss account. As at 31 December 2008 a further impairment loss in the amount RUB 218 028 thousand – measured as the difference between the current fair value and the original cost of acquisition of these investments - was recognised in the profit and loss account. Therefore overall impairment effect of available-for-sale investment is RUB 341 133 thousand was recognized in the profit and loss account. (see Note 21).

(in thousands of Russian Roubles, except per share amounts)

Note 8. Income Tax

	Year ended 31 December 2008	Year ended 31 December 2007
Current income tax charge	(157 804)	-
Deferred income tax charge	(443 020)	(1 098 298)
Effect of the change in the tax rate	479 218	-
Income tax charge	**(121 606)**	**(1 098 298)**

In 2008 and 2007 the Group was subject to a 24% income tax rate on taxable profits.

Most companies of the Group were subject to tax rates of 24% on taxable profits in the Russian Federation for 2008 and 2007. With effect from 1 January 2009, the rate of profits tax payable by companies in the Russian Federation can range from 15.5% to 20%, depending on applicable rates set by regional authorities. Deferred tax asset/liabilities are measured at the rate of 20% and 24% as at 31 December 2008 and 31 December 2007 respectively.

Reconciliation between the expected and the actual taxation charge is provided below:

	Year ended 31 December 2008	Year ended 31 December 2007
Profit before tax	1 137 698	3 495 477
Theoretical tax charge at the statutory tax rate of 24%	(273 048)	(838 914)
Tax effects of items which are non-deductible for income tax purposes	(327 776)	(259 384)
Effect of the change in the tax rate	479 218	-
Income tax charge	**(121 606)**	**(1 098 298)**

Deferred tax assets and liabilities

Differences between IFRS and Russian statutory taxation regulations give rise to certain temporary differences between the carrying value of certain assets and liabilities for financial reporting purposes and their tax bases. Deferred tax assets and liabilities are measured at the rate of 20% as at 31 December 2008 and 24% as at 31 December 2007 which is expected to be applied to the period when the assets are realised and liabilities are settled.

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

Deferred tax liabilities:	**31 December 2007**	**(Charged)/ credited to income statement**	**(Charged) to equity**	**Disposal of subsidiaries**	**Effect of the change in income tax rate**	**31 December 2008**
Property, plant and equipment	(2 826 441)	(534 817)	-	-	560 209	(2 801 049)
Investments	(28 085)	(1 267)	(29 545)	-	9 816	(49 081)
Accounts receivable	(118 137)	(121 386)	-	-	39 921	(199 602)
Accounts payable and accrued liabilities	154 369	74 055	-	-	(38 071)	190 353
Tax loss carried forward	148 673	(37 669)	-	-	(18 501)	92 503
Other	65 913	(44 390)	-	-	(3 587)	17 936
Total deferred tax liability	**(2 603 708)**	**(665 474)**	**(29 545)**	**-**	**549 787**	**(2 748 940)**

(in thousands of Russian Roubles, except per share amounts)

Note 8. Income Tax (Continued)

Deferred tax liabilities:	31 December 2006	(Charged)/ credited to income statement	Credited to equity	Disposal of subsidiaries	31 December 2007
Property, plant and equipment	(1 668 803)	(1 172 433)	-	14 795	(2 826 441)
Investments	(187 330)	116 190	43 055	-	(28 085)
Accounts receivable (including long-term receivables)	(77 564)	(40 573)	-	-	(118 137)
Accounts payable and accrued liabilities	137 474	16 895	-	-	154 369
Tax loss carried forward	183 419	(34 746)	-	-	148 673
Other	34 678	31 235	-	-	65 913
Total deferred tax liability	**(1 578 126)**	**(1 083 432)**	**43 055**	**14 795**	**(2 603 708)**

Deferred tax assets	31 December 2007	(Charged)/ credited to income statement	Effect of the change in income tax rate	31 December 2008
Property, plant and equipment	(16 712)	4 595	2 019	(10 098)
Tax loss carried forward	222 147	136 346	(59 749)	298 744
Accounts receivable	4 215	52 853	(9 511)	47 557
Accounts payable and accrued liabilities	(13 569)	29 084	(2 586)	12 929
Other	4 881	(424)	(742)	3 715
Total deferred tax assets	**200 962**	**222 454**	**(70 569)**	**352 847**

Deferred tax assets	31 December 2006	(Charged)/ credited to income statement	31 December 2007
Property, plant and equipment	32 386	(49 098)	(16 712)
Tax loss carried forward	156 351	65 796	222 147
Accounts receivable	10 146	(5 931)	4 215
Accounts payable and accrued liabilities	10 822	(24 391)	(13 569)
Other	6 212	(1 331)	4 881
Total deferred tax assets	**215 917**	**(14 955)**	**200 962**

Note 9. Other Non-Current Assets

	31 December 2008	31 December 2007
Long-term receivables (interest free)	387 255	159 935
Promissory notes	19 591	-
Loans issued	-	34 014
Total financial receivables	**406 846**	**193 949**
VAT in prepayments on capital construction	934 752	584 292
Prepayments for property, plant and equipment	-	1 270 970
Total other non-current assets	**1 341 598**	**2 049 211**

Long-term receivables and loans issued are recorded at amortised cost. Loss on discounting of long-term receivables is included in finance cost. The amount of the discount as at 31 December 2008 is RUB 113 914 thousand (31 December 2007: RUB 117 742 thousand).

(in thousands of Russian Roubles, except per share amounts)

Note 10. Cash and Cash Equivalents

	31 December 2008	31 December 2007
Short-term deposits in RUB (effective interest rate: 8%)	796 000	13 851 428
Cash in bank and in hand in RUB (effective interest rate: 0%)	963 572	2 021 546
Foreign currency accounts (primarily EUR)	299 046	103 575
Total	**2 058 618**	**15 976 549**

Note 11. Available-for-sale Investments

Bank deposits	Currency	31 December 2008	31 December 2007
OJSC Alfabank (interest rate: 8%)	RUB	-	4 004 000
JSCB Vozrozhdenie Bank (interest rate 0%)	RUB	-	101 356
Bank Rossiya	Euro	248 648	-
Gazenergoprombank	RUB	66 762	-
Total		**315 410**	**4 105 356**

Note 12. Accounts Receivable and Prepayments

	31 December 2008	31 December 2007
Trade receivables, net of provision for impairment of RUB 248 840 thousand (31 December 2007: RUB 54 760 thousand)	4 294 528	3 192 192
Other receivables, net of provision for impairment of RUB 30 400 thousand (31 December 2007: RUB 30 400 thousand)	671 494	551 480
Total financial receivables	**4 966 022**	**3 743 672**
Value-added tax receivable	2 612 928	872 464
Advances to suppliers	664 483	731 149
Other taxes receivable	7 337	695 841
Total accounts receivable and prepayments	**8 250 770**	**6 043 126**

Note 13. Inventories

	31 December 2008	31 December 2007
Fuel supplies	1 664 511	1 516 709
Spare parts	489 269	483 815
Raw materials and other supplies	432 673	374 722
Total	**2 586 453**	**2 375 246**

Raw materials and other supplies are recorded net of provision for impairment in the amount of RUB 17 319 thousand (31 December 2007: RUB 40 346 thousand).

Note 14. Equity

14.1 Share capital

	31 December 2008	31 December 2007
Number of ordinary shares authorised, issued and fully paid (thousands)	3 854 341 417	3 850 959 750
Nominal value (in RUB)	0.01	0.01

The following movements of share capital of the Company took place for year ended 31 December 2007 and 31 December 2008:

- In May 2007, the Company issued 23 022 969 435 ordinary shares for the purposes of share exchange for the shares of OJSC Murmanskaya TPP, an entity under control of RAO UES (see also Note 1). Consistent with the previous combinations amongst entities under common control of RAO UES, the Group accounted for the assets and liabilities of Murmanskaya TPP as if it had been the Group's subsidiary from the earliest period presented in the Financial Statements. Difference between the carrying value of the net assets and the minority interest of the merged subsidiary was included in the Merger reserve of the Group as at that date. As a result of the share issue, Merger reserve decreased by RUB 317 198 thousand for the year ended 31 December 2007.

Note 14. Equity (Continued)

- In October 2007, the Company issued 925 714 285 713 ordinary shares in exchange for RUB 32 400 000 thousand, net of costs of issuing shares. The share premium in respect of this issue in the amount of RUB 23 142 857 thousand was reflected in equity. As disclosed in Note 1, this share issue was acquired by LLC Russian Energy Projects and Fortum Heat and Power Oy as follows: 680 279 520 000 shares were acquired by LLC Russian Energy Projects and 245 434 765 713 shares were acquired by Fortum. The shareholding structure after the issue is disclosed in Note 1.
- Supporting documents for the transactions costs in amount RUB 422 308 for issuance of 925 714 285 713 ordinary shares in October 2007 were received in 2008 and therefore these transactions costs were accounted for in 2008 (i.e. were not deducted from 2007 equity).
- As described in Note 1, on 29 October 2007 the Extraordinary General Meeting of Shareholders of TGC-1 approved additional issue of shares for the purpose of the merger of OJSC "TGC-1 Holding" into the Company. In accordance with the Russian legislation all shareholders of the Company who voted against reorganisation or did not participate in voting on reorganisation could request the Company to buy out all or part of their shares. Consequently, in 2007 the Company purchased its shares from minority shareholders for RUB 20 558 thousand (674 041 000 shares at a price of RUB 0.0305 per share). On the other hand, 1 000 000 000 treasury shares of the Company were distributed among existing shareholders at their nominal value of RUB 0.01 per share.
- In April 2008 the Company made an additional issue of 3 381 666 366 ordinary shares for the total amount of 33 816 thousand roubles was performed. This additional issue of shares and further shares of the Company which were purchased from minority shareholders for RUB 20 558 thousand (674 041 000 shares at a price of RUB 0.0305 per share) were used for the purpose of merger of OJSC "TGC-1 Holding" into OJSC TGC -1 by converting ordinary and preference shares of OJSC "TGC-1 Holding" into ordinary shares of OJSC TGC-1 in accordance with the following converting ratio:
  - 0.0261552883800093 ordinary share of OJSC "TGC-1 Holding" were converted into one ordinary share of the Company with par value of RUB 0.01 each;
  - 0.0285600440926069 preference share of OJSC "TGC-1 Holding" were converted into one preference share of the Company with par value of RUB 0.01 each.

  As a result of merger OJSC "TGC-1 Holding" the Company received the assets in the amount RUB 104 759 thousand. The difference between the assets received as result of acquisition and share capital used for purpose of merger was posted to share premium.

  After this transaction, the share capital of the Group as at 31 December 2008 totalled at RUB 38 543 414 thousand, being 3 854 341 416 571 ordinary shares with a par value RUB 0.01 each.

14.2 Dividends

In accordance with the Russian legislation, the Group distributes profits as dividends or transfers them to reserves (fund accounts) on the basis of financial statements prepared in accordance with Russian Accounting Rules. The statutory accounting reports of the Company are the basis for profit distribution and other appropriations. Russian legislation identifies the basis of distribution as the net profit. For 2008, the current year statutory net profit for the Company, as reported in the published annual statutory reporting forms, was RUB 231 321 thousand (2007: RUB 124 122 thousand) and the closing balance of the accumulated losses including the current year statutory net profit totalled RUB 15 500 197 thousand (31 December 2007: RUB 15 864 123 thousand). However, this legislation and other statutory laws and regulations are open to legal interpretation and, accordingly, management believes at present it would not be appropriate to disclose an amount for distributable reserves in these consolidated financial statements.

In May 2007, the Company declared dividends for the first quarter of 2007 of RR 0.00002839307 per share totalling RUB 85 304 thousand.

In June 2007, the Company declared dividends for the year ended 31 December 2006 of RUB 0.000103369 per share totalling RUB 300 000 thousand.

(in thousands of Russian Roubles, except per share amounts)

Note 15. Long-term Borrowings

	Currency	Effective interest rate	Maturity	31 December 2008	31 December 2007
Long-term bonds	RUB	7.75%	2014	1 143 503	3 849 000
NORDIC investment bank	Euro	EURIBOR+3%	2014	1 051 965	1 077 995
European Bank for Reconstruction and Development	Euro	EURIBOR+2.75%	2010	497 294	718 664
Nordic environment finance corporation	Euro	EURIBOR+2.00%	2015	124 324	-
				2 817 086	**5 645 659**
Less: current portion					
Long-term bonds				-	(3 849 000)
NORDIC investment bank				(191 266)	(165 845)
European Bank for Reconstruction and Development				(331 529)	(287 465)
Nordic environment finance corporation				(10 361)	-
Total long-term borrowings				**2 283 930**	**1 343 349**

The fair value of long-term bonds (including the current portion) was estimated by management on the basis of future contracted cash flows and marketable interest rates on similar instruments applicable to the Group as at 31 December 2008. (see Note 25.8).

In March 2007 the Company issued 4 000 000 bonds at a nominal value of RUB 1 000 per bond, with the coupon rate of 7.75%, maturing in 2014.

As disclosed in Note 1, in October 2007 the Extraordinary General Meeting of the Shareholders of the Company made a decision on merging of OJSC "TGC-1 Holding" into the Group. According to the Russian legislation, once the decision on reorganisation is approved by the shareholders, the bond holders could claim their bonds for immediate repayment. Therefore, the long-term bonds issued have been reclassified into current liabilities in these consolidated financial statements as at 31 December 2007.

As disclosed in Note 1, in July 2008 the reorganisation was finished and According to the Russian legislation the bond holders right for immediate repayment was lost after the reorganisation. Therefore as at 31 December 2008 Management of the Company change back the presentation of the bond to long-term liabilities.

Compliance with covenants. In accordance with the long-term borrowings facility agreements, the Group is required to comply with certain financial and non-financial covenants. The most significant and most important covenants are:

- not to sell, transfer, lease, divest or otherwise dispose of certain equipment;
- to maintain certain ratios: EBITDA to Finance Charges, total debt to equity and Current Ratio;
- to maintain certain liquidity and debt-to-assets ratio.

In case of breach of these covenants the schedule of repayment can be changed by the respective lender, up to immediate repayment. Management does not believe that the Group is in danger of breaching the covenants imposed.

The following assets were pledged as collateral under the long-term borrowings:

	31 December 2008	31 December 2007
Property, plant and equipment (net book value)	309 029	355 880
Total	**309 029**	**355 880**

Note 16. Post-Employment Benefits

The Group operates defined benefit and defined contribution pension plans. In respect of some of these plans the Group has a contract with a pension fund "Non-state pension fund of electrical energy industry" ("NPFE"), which is a separate legal entity; the other plans are operated by the Group without engaging pension funds. Defined contribution plans are considered immaterial for disclosure.

(in thousands of Russian Roubles, except per share amounts)

Note 16. Post-Employment Benefits (Continued)

The defined benefit pension plan through NPFE provides for monthly pension benefit paid upon retirement. Annual contributions are made by the Group to the solidarity account in the non-state pension fund. Amount of the contribution is defined by the Group's budget and is considered to be enough at least to finance running pension benefits. No part of this contribution is recognised as plan asset as far as the Group can recall this money back and the plan is considered as unfunded thereat. Pension benefits are paid from the solidarity account on 'pay-as-go' basis.

Additionally to the NPFE pension plan, the Group provides financial support, of a defined benefit nature, to its old-age pensioners, who have completed certain service for the Group, and other post-employment benefits such as lump-sum payments upon retirement, lump-sum material aid, etc.

The tables below provide information about the benefit obligations, plan assets and actuarial estimations used for the years ended 31 December 2008 and 31 December 2007.

Amounts recognised in the consolidated balance sheet:

	31 December 2008	31 December 2007
Defined benefit obligations	954 885	1 016 212
Unrecognised net actuarial losses	(95 301)	(260 614)
Unrecognised past service cost	(173 318)	(151 577)
Net liability on the balance sheet	**686 266**	**604 021**

Amounts recognised in the consolidated income statement:

	Year ended 31 December 2008	Year ended 31 December 2007
Current service cost	53 850	53 416
Interest cost	69 450	47 316
Past service cost	17 881	9 268
Actuarial losses on obligation	(2 012)	33 906
Total	**139 169**	**143 906**

Changes in the present value of the Group's defined benefit obligations are as follows:

	Year ended 31 December 2008	Year ended 31 December 2007
Benefit obligations		
Benefit obligations as at the beginning of the period	1 016 212	705 224
Current service cost	53 850	53 416
Interest cost	69 450	47 316
Past service cost	39 622	(5 168)
Benefits paid	(56 924)	(45 494)
Actuarial (gains) / losses	(167 324)	260 918
Benefit obligations as at the end of the period	**954 886**	**1 016 212**

The principal actuarial estimations are as follows:

	31 December 2008	31 December 2007
Discount rate for benefits at accumulation phase	9.00%	6.75%
Future salary increase	8.00%	7.00%
Future inflation rate	7.00%	6.00%

(in thousands of Russian Roubles, except per share amounts)

Note 17. Short-Term Borrowings and Current Portion of Long-Term Borrowings

Name of lender	Currency	Effective interest rate	31 December 2008	31 December 2007
OJSC "VTB North-West"	RUB	8.0-12.5%	1 500 000	-
OJSC Alfabank	RUB	10-12%	-	283 300
OJSC Petroenergobank	RUB	7.0 - 7.5%	-	250 000
OJSC "AB Russia"	RUB	8.0-18%	400 000	-
Other borrowings from third parties	RUB	3.0%	-	100 000
Current portion of long-term borrowings (Note 15):				
Bonds	RUB	7,75%	-	3 849 000
Nordic environment finance corporation	Euro	EURIBOR+2.00%	10 361	-
European Bank for Reconstruction and Development	Euro	EURIBOR+2.75%	331 529	287 465
NORDIC investment bank		EURIBOR+3%	191 266	165 845
Total			**2 433 156**	**4 935 610**

Note 18. Accounts Payable and Accrued Liabilities

	31 December 2008	31 December 2007
Trade accounts payable	2 240 841	2 357 816
Accounts payable for capital construction	6 208 612	1 931 205
Accrued liabilities and other payables	173 259	225 670
Interest accrued on loans	74 644	125 525
Total financial payables	**8 697 356**	**4 640 216**
Advances from customers	1 558 442	1 391 239
Employee benefits	126 415	102 786
Total accounts payable and accrued liabilities	**10 382 213**	**6 134 241**

Note 19. Other Taxes Payable

	31 December 2008	31 December 2007
Property tax	138 319	121 686
Water usage tax	66 950	55 806
Employee taxes	34 052	36 409
VAT provision, related penalties and late payment interest	209 916	-
Other taxes	20 761	36 074
Total	**469 998**	**249 975**

Note 20. Tax Provision

Following the results of a tax inspection of the Company for the period from 25 March 2005 to 31 December 2006 finalised in March 2009, management recorded a provision in respect of additional taxes, penalties and late payment interest as presented below:

	Income tax payable	Taxes other than on income, and penalties	Total
Carrying value at 31 December 2007	-	-	-
Charged to income statement	120 136	209 916	330 052
Carrying value at 31 December 2008	**120 136**	**209 916**	**330 052**

(in thousands of Russian Roubles, except per share amounts)

Note 21. Operating Expenses, net

	Year ended 31 December 2008	Year ended 31 December 2007
Fuel	15 546 084	12 164 266
Employee benefits	4 818 686	4 104 414
Electricity and heat purchases	2 844 902	2 705 590
Depreciation	2 750 427	2 044 821
Water usage expenses	1 681 541	1 504 260
Repairs and maintenance	1 231 884	1 176 047
Heat distribution	1 134 582	985 111
Taxes other than income tax	929 145	865 491
Other materials	336 746	339 605
Lease expenses	254 844	311 938
Consulting, legal and audit services	228 142	282 140
Security services	308 958	281 009
Transportation services	204 926	184 672
Insurance cost	188 936	166 756
Telecommunication services	102 584	84 115
Provision for/(release of) impairment of accounts receivable	194 080	(28 767)
Impairment of available for sale investments	341 133	-
Change in financial assets through profit and loss	-	94 267
Loss on disposal of subsidiaries	-	44 940
Provision charge for taxes other than on income and penalties	209 916	-
Other operating expenses	1 142 637	1 194 049
Other operating income	(713 251)	(299 759)
Total	**33 736 902**	**28 204 965**

Note 22. Finance Cost, net

	Year ended 31 December 2008	Year ended 31 December 2007
Interest expense	280 194	574 882
Interest income	(550 166)	(324 803)
Net finance cost	**(269 972)**	**250 079**

Note 23. Earnings per Share

	Year ended 31 December 2008	Year ended 31 December 2007
Profit attributable to the shareholders of TGC-1	1 051 410	2 409 513
Weighted average number of ordinary shares issued (thousands)	3 852 659 823	3 088 279 118
Earnings per ordinary share attributable to the shareholders of TGC-1 – basic and diluted – in Russian Roubles	0.0003	0.0008

Note 24. Commitments

24.1 Sales commitments

The Group sells electricity in two wholesale market sectors: free trading sector and regulated trading sector. The tariffs for the electricity sold/purchased in the regulated trading sector (including the sector of deviations) are set by the Federal Service on Tariffs.

As at 31 December 2008, the Group entered into a number of annual electricity sales agreements with CJSC Centre for Financial Settlements, CJSC Inter RAO UES, retail companies and large industrial customers. The total amount of electricity sales commitments (net of VAT) was RUB 9 410 683 thousand (31 December 2007: RUB 10 835 558 thousand).

24.2 Fuel commitments

The Group concluded a number of contracts for fuel supply. Main supplier of gas is CJSC Peterburgregiongaz (subsidiary of OJSC Gazprom, controlled by the State) and the main supplier of coal is OJSC Plant Polymer. The prices for natural gas and coal stipulated in the contracts are mainly determined on the basis of tariffs established by the FST, published inflation rates and current market prices.

Note 24. Commitments (Continued)

24.3 Contractual capital commitments

As at 31 December 2008, the Group had outstanding contractual commitments in respect of construction of property, plant and equipment in the amount of RUB 48 810 469 thousand (31 December 2007: RUB 44 126 025 thousand).

Note 25. Contingencies

25.1 Political environment

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

25.2 Insurance

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

25.3 Legal proceedings

The Group is a party to certain legal proceedings arising in the ordinary course of business. In the opinion of management, there are no current legal proceedings or other claims outstanding and not provided which, upon final disposition, will have a material adverse effect on the financial position of the Group.

25.4 Tax legislation

Russian tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Group may be challenged by the relevant regional and federal authorities. The Russian tax authorities may be taking a more assertive position in their interpretation of the legislation and assessments, and it is possible that transactions and activities that have not been challenged in the past may be challenged. In October 2006, the Supreme Arbitration Court issued guidance to lower courts on reviewing tax cases providing a systemic roadmap for anti-avoidance claims, and it is possible that this will significantly increase the level and frequency of tax authorities scrutiny. As a result, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

As at 31 December 2008 the tax provision reflected in profit and loss of RUB 330 052 thousand related to pricing and documentation of certain transactions (see Note 20).

As at 31 December 2008 The Group estimates that it has potential obligations from exposure to possible tax risks related to pricing and documentation of certain transactions, of RUB 871 466 thousand (31 December 2007: RUB 756 800 thousand).

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

25.5 Environmental matters

The enforcement of environmental regulation in the Russian Federation is evolving and the enforcement posture of government authorities is continually being reconsidered. The Group periodically evaluates its obligations under environmental regulations.

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

25.6 Compliance with covenants

The Group is subject to certain covenants related to its long-term borrowings (see Note 15). Non-compliance with such covenants may result in negative consequences for the Group including growth in the cost of borrowings and declaration of default. The Group's management believes that the Group is in compliance with covenants.

(in thousands of Russian Roubles, except per share amounts)

Note 26. Financial Risk Management

26.1 Financial risks

The Group's activities expose it to a variety of financial risks including market risk (currency risk, interest rate risk and other price risk), credit risk and liquidity risk. The Group does not have a formal risk policy to hedge its financial exposures.

26.2 Credit risk

Financial assets, which potentially subject the Group to concentrations of credit risk, consist principally of trade receivables. Although collection of receivables could be influenced by economic factors, management believes that there is no significant risk of loss to the Group beyond the provision for impairment of receivables already recorded.

Cash transactions are conducted through high-credit-quality financial institutions. Cash is placed in financial institutions, which are considered at time of deposit to have minimal risk of default.

The table below shows the rating and balances with major banks at the balance sheet dates:

	Rating agency	National scale ratings	Note	Long-term RDE* in foreign currency	31 December 2008	31 December 2007
Cash at bank						
SEB Bank	-	-		-	332 367	227 159
Bank St.Petersburg	Fitch	-		B	1 953	121 988
Sberbank	Fitch			BBB	15 250	7 265 214
NB Trust	Fitch	-		B-	1 531	128 913
Alfabank	Fitch	AA+(rus)		BB-	87 862	2 006 570
VTB	Fitch	AAA(rus)		BBB	31 695	5 439 025
Bank Rossiya	Fitch	BB-(rus)		B-	175 090	643 091
Gazenergo prombank		-		-	1 364 475	-
Other	-	-		-	48 395	144 589
Total			10		**2 058 618**	**15 976 549**
Bank deposits						
Alfabank	Fitch	AA+(rus)		BB-	-	4 004 000
Bank Rossiya	Fitch	BB-(rus)		B-	248 648	-
Total			11		**248 648**	**4 004 000**

** Rating of the default of the emitter*

Promisory notes	-					
Vozrozhdeniye	-				-	101 356
Gazenergopro mbank					66 762	-
Total			11		**66 762**	**101 356**

At the balance sheet date there were no significant concentrations of credit risk. The maximum exposure to credit risk at the reporting date without taking account of any collateral held is as follows:

	31 December 2008	31 December 2007
Cash and cash equivalents (Note 10)	2 058 618	15 976 549
Available-for-sale investments (Note 11)	315 410	4 105 356
Total financial receivables (Note 12)	4 966 022	3 743 672
Other non-current assets (Note 9)	406 846	193 949
Total	**7 746 896**	**24 019 526**

Total financial receivables by type of customers are presented in the table below:

	31 December 2008	31 December 2007
End-user customers	3 297 219	2 758 430
Wholesale customers	782 288	457 718
RAO UES Group	-	341 945
Free market	837 400	175 642
Export	49 115	9 937
Total	**4 966 022**	**3 743 672**

(in thousands of Russian Roubles, except per share amounts)

Note 26. Financial Risk Management (Continued)

Total financial receivables on a contract basis as at the reporting date are presented in the table below:

	Fully performing	Past due but not impaired	Impaired
Total financial receivables as at 31 December 2008	3 980 814	985 208	279 240
Total financial receivables as at 31 December 2007	2 807 289	936 383	85 160

Fully performing trade receivables relate to a number of independent customers for whom there is no recent history of default. The majority of performing trade receivables are represented by large number of individually insignificant end-user customers, therefore the credit risk is widely spread.

Past due but not impaired financial receivables have the following ageing structure:

	31 December 2008	31 December 2007
Up to 45 days	419 128	408 520
From 45 to 90 days	109 292	177 014
More than 90 days	456 788	350 849
Total	**985 208**	**936 383**

Movements in impairment provision for financial receivables are as follows:

	Year ended 31 December 2008	Year ended 31 December 2007
Provision for impairment as at 1 January	**85 160**	**121 444**
Impairment loss recognised during the period	195 502	2 885
Impairment loss reversed during the period	-	(31 652)
Consumed	(1 422)	(7 517)
Provision for impairment as at 31 December	**279 240**	**85 160**

26.3 Currency risk

The Group takes on exposure to effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. At 31.12.2008, the Group had the following currency positions:

	RUB	USD	EUR	Total
Monetary financial assets				
Cash in bank	1 759 572	7 515	291 531	2 058 618
Available-for-sale investments	66 762	-	248 648	315 410
Total financial receivables	4 871 057	566	94 399	4 966 022
Other non-current assets	406 846	-	-	406 846
Total financial assets	**7 104 237**	**8 081**	**634 578**	**7 746 896**
Monetary financial liabilities				
Long-term borrowings	(1 143 503)	-	(1 140 427)	(2 283 930)
Short-term borrowings	(1 900 000)	-	(533 156)	(2 433 156)
Total other financial liabilities	(8 696 791)	-	(565)	(8 697 356)
Total financial liabilities	**(11 740 294)**	**-**	**(1 674 148)**	**(13 414 442)**
Net balance sheet position	**(4 636 057)**	**8 081**	**(1 039 570)**	**(5 667 546)**

As at 31 December 2007, the Group had the following currency positions:

	RUB	USD	EUR	Total
Monetary financial assets				
Cash in bank	15 872 974	8 850	94 725	15 976 549
Available-for-sale investments	4 105 356	-	-	4 105 356
Total financial receivables	3 743 672	-	-	3 743 672
Other non-current assets	193 949	-	-	193 949
Total financial assets	**23 915 951**	**8 850**	**94 725**	**24 019 526**
Monetary financial liabilities				
Long-term borrowings	-	-	(1 343 349)	(1 343 349)
Short-term borrowings	(4 482 300)	-	(453 310)	(4 935 610)
Total other financial liabilities	(4 640 216)	-	-	(4 640 216)
Total financial liabilities	**(9 122 516)**	**-**	**(1 796 659)**	**(10 919 175)**
Net balance sheet position	**14 793 435**	**8 850**	**(1 701 934)**	**13 100 351**

(in thousands of Russian Roubles, except per share amounts)

Note 26. Financial Risk Management (Continued)

26.4 Liquidity risk

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group's liquidity risk management includes maintaining sufficient cash to fund operations and the investment programme and the availability of funding from an adequate amount of committed credit facilities.

The table below analyses the Group's financial liabilities into relevant maturity groupings based on the remaining period at the balance sheet to the contractual maturity date, based on the contractual undiscounted amounts, including future interest payments.

As at 31 December 2008

	Carrying amount	Contractual cash flows	Within 6 months	6-12 months	1-2 years	2-5 years	More than 5 years
Borrowings	4 717 086	5 181 948	794 072	2 034 944	446 652	649 898	1 256 382
Total other financial liabilities	8 697 356	8 697 356	8 697 356	-	-	-	-
Total	**13 414 442**	**13 879 304**	**9 491 428**	**2 034 944**	**446 652**	**649 898**	**1 256 382**

As at 31 December 2007

	Carrying amount	Contractual cash flows	Within 6 months	6-12 months	1-2 years	2-5 years	More than 5 years
Borrowings	6 278 959	6 829 176	4 545 322	693 534	918 948	671 372	-
Total other financial liabilities	4 640 216	4 640 216	4 640 216	-	-	-	-
Total	**10 919 175**	**11 469 392**	**9 185 538**	**693 534**	**918 948**	**671 372**	-

As at 31 December 2008, the contractual cash flows for financial liabilities were translated using the following rates: CB RF official exchange rates as at 31 December 2008 of EUR 1 = RUB 41.4411 (31 December 2007: EUR 1 = RUB 35.9332) and future interest was calculated using EURIBOR effective rate as at 31 December 2008 of 3.202% (31 December 2007: 4.745%).

26.5 Market risk

The Group exports part of produced electricity to Finland and Norway and is exposed to foreign exchange risk arising from various currency exposures, primarily with respect to the Euro. Foreign exchange risk arises on foreign currency denominated borrowings (see Note 15 and Note 17). The Group does not have formal arrangements to mitigate this risk.

At 31 December 2008, if the Russian Rouble had weakened/strengthened by 33% (2007: 10%) against the EUR with all other variables held constant, the post-tax profit for the year would have been RUB 343 058 thousand (2007: RUB 170 192 thousand) lower/higher. Since the Group does not hold any financial instruments revalued through equity, the effect of change of exchange rate on equity would be the same as on post-tax profit.

26.6 Interest rate risk

The Group's operating profits and cash flows from operating activity are largely independent of changes in market interest rates. The Group's interest rate risk arises from borrowings. Borrowings issued at variable rates expose the Group to cash flow interest rate risk. Borrowings issued at fixed rates expose the Group to fair value interest rate risk.

At the reporting date the interest rate profile of the Group's interest-bearing financial instruments was:

	Carrying amount	
	31 December 2008	**31 December 2007**
Fixed rate instruments		
Long-term loans and borrowings	1 143 503	-
Short-term loans and borrowings	1 900 000	4 482 300
Variable rate instruments		
Long-term loans and borrowings	1 140 427	1 343 349
Short-term loans and borrowings	533 156	453 310
Total	**4 717 086**	**6 278 959**

(in thousands of Russian Roubles, except per share amounts)

Note 26. Financial Risk Management (Continued)

The Group analyses its interest rate exposure on a regular basis. Various scenarios are simulated taking into consideration refinancing, renewal of existing positions and alternative financing. Based on these scenarios, the Group calculates the impact on profit and loss of a defined interest rate shift.

A general increase/decrease of one percent in interest rates would have increased/decreased the Group's profit after income tax for the year ended 31 December 2008 by approximately RUB 32 873 thousand (for the year ended 31 December 2007: RUB 1 347 thousand). The effect on equity (retained earnings) would be the same as on post-tax profit.

26.7 Fair value sensitivity analysis for fixed rate instruments

In 2008 the Group did not hold any fixed rate financial assets and liabilities at fair value through profit or loss, and the Group did not designate derivatives as hedging instruments under a fair value hedge accounting model. Therefore a change in interest rate at the reporting date would not affect profit or loss.

26.8 Fair values

The fair value of long-term bonds (including the current portion) as estimated by management on the basis of future contracted cash flows and marketable interest rates on similar instruments applicable to the Group is less than its carrying value in the amount of RUB 323 424 thousand as at 31 December 2008. The fair value of long-term bonds (including the current portion) as estimated by management on the basis of future contracted cash flows and marketable interest rates on similar instruments applicable to the Group equalled to it's carrying value as at 31 December 2007

Management believes that the fair values of the Group's other financial assets and liabilities approximate their carrying values as of both year ends.

26.9 Capital risk management

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

In order to maintain or adjust the capital structure, the Group may adjust the amount of dividends paid to equity holders, return capital to equity holders or issue new shares.

The Group monitors capital on the basis of the gearing ratio to be consistent with other companies in the industry. This ratio is calculated as net debt divided by total equity. Net debt is calculated as total borrowings (including borrowings and trade and other payables, as shown in the consolidated balance sheet) less cash and cash equivalents. Total capital is calculated as equity (net of minority interest), as shown in the consolidated balance sheet, plus net debt. Management of capital is linked to maintaining certain financial ratios to comply with covenants imposed by the banks (see Note 15).

During 2008, the Group's strategy, which was unchanged from 2007, was to maintain a gearing ratio between net debt and equity not higher than 0.6. The gearing ratios at 31 December 2008 and 31 December 2007 were as follows:

	31 December 2008	31 December 2007
Total borrowings	4 717 086	6 278 959
Trade and other liabilities	10 382 213	6 134 241
Less: cash and cash equivalents	(2 058 618)	(15 976 549)
Net debt	13 040 681	(3 563 349)
Total equity	59 951 735	59 124 314
Total capital	**72 992 416**	**55 573 297**
Debt % in Capital Structure	17.87%	(6.41%)
Equity % in Capital Structure	82.13%	106.39%
Gearing ratio	0.22	(0.06)

Note 27. Subsequent Events

On 27 February 2009 a loan facility agreement for the purpose of financing TGC-1's investment program between CJSC "GlobeksBank" (subsidiary of State Corporation «The Bank for Development and Foreign Economic Affairs (Vnesheconombank)») and OJSC TGS-1 was signed for the period from 27 February 2009 till 26 February 2010. The credit limit under the facility was settled in amount of RUB 2 000 000 thousand and the interest rate fixed at 17,8 percent per annum.

Note 27. Subsequent Events (Continued)

On 18 February 2009 The OJSC TGC-1's Board of Directors approved the decision to increase its share in OJSC "Murmanskaya TPP" (as at 31 December 2008 Company owns 84.06% of Murmanskaya TPP - see Note 1.1) up to 100 percent by means of realization of an obligatory proposal in respect of the acquisition of ordinary and preference shares of type A.