RAO UES GROUP
IFRS CONSOLIDATED INTERIM FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED 30 JUNE 2004

ZAO KPMG
11 Gogolevsky Boulevard
Moscow 119019
Russia

Telephone +7 (095) 937 4477
Fax +7 (095) 937 4400/99
Internet www.kpmg.ru

Independent Auditor's Report

Board of Directors
OAO RAO UES of Russia

We have audited the accompanying consolidated interim balance sheet of OAO RAO UES of Russia and its subsidiaries (the "Group") as of 30 June 2004 and the related interim statements of operations, changes in shareholders' equity and cash flows for the six month period then ended. These consolidated interim financial statements, as set out on pages 2 to 32, are the responsibility of the Group's management. Our responsibility is to express an opinion on these interim financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing as issued by the International Federation of Accountants. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated interim financial statements present fairly, in all material respects, the financial position of the Group as of 30 June 2004, and the results of its operations, changes in shareholders' equity and cash flows for the six month period then ended in accordance with International Financial Reporting Standards promulgated by the International Accounting Standards Board.

ZAO KPMG

ZAO KPMG
Moscow, Russian Federation
26 October 2004

RAO UES Group

Consolidated Interim Balance Sheet as at 30 June 2004

(in millions of Russian Roubles)

	Notes	30 June 2004	31 December 2003
Assets			
Non-current assets			
Property, plant and equipment	8	867,641	872,179
Investments in associates		32	196
Deferred profit tax assets	15	3,531	3,881
Other non-current assets	9	33,321	26,200
Total non-current assets		**904,525**	**902,456**
Current assets			
Cash and cash equivalents	10	40,148	31,978
Accounts receivable and prepayments	11	121,644	105,340
Inventories	12	42,108	42,731
Other current assets		4,540	5,036
Total current assets		**208,440**	**185,085**
Total assets	6	**1,112,965**	**1,087,541**
Shareholders' equity and liabilities			
Shareholders' equity	13		
Share capital			
Ordinary shares (nominal value RR 20,521 million)		147,439	147,439
Preference shares (nominal value RR 1,038 million)		7,667	7,667
Treasury shares		(355)	(355)
		154,751	154,751
Retained earnings and fair value reserve		445,443	432,553
Total shareholders' equity		**600,194**	**587,304**
Minority interest	14	**225,377**	**219,687**
Non-current liabilities			
Deferred profit tax liabilities	15	58,299	57,895
Non-current debt	16	17,236	12,556
Other non-current liabilities	17	22,263	24,202
Total non-current liabilities		**97,798**	**94,653**
Current liabilities			
Current debt and current portion of non-current debt	18	51,314	50,496
Accounts payable and accrued charges	19	94,658	89,758
Taxes payable	20	43,624	45,643
Total current liabilities		**189,596**	**185,897**
Total liabilities	6	**287,394**	**280,550**
Total shareholders' equity and liabilities		**1,112,965**	**1,087,541**

Chairman of the Management Board — Chubais A.B.

Financial Director — Zhurba D.G.

26 October 2004

RAO UES Group

Consolidated Interim Statement of Operations for the six months ended 30 June 2004

(in millions of Russian Roubles)

	Notes	Six months ended 30 June 2004	Six months ended 30 June 2003
Revenues			
Electricity		255,166	225,184
Heating		65,408	58,089
Governmental assistance	21	2,266	2,229
Other		19,888	15,345
Total revenues	6	**342,728**	**300,847**
Costs and other deductions			
Fuel expenses		96,425	85,213
Wages, benefits and payroll taxes		47,735	44,071
Purchased power		37,885	35,669
Depreciation and property, plant and equipment impairment	8	33,574	30,048
Repairs and maintenance		22,626	18,301
Taxes other than on income		10,839	10,104
Other materials		5,572	7,241
Electricity and heat distribution		4,317	2,482
Doubtful debtors expense		3,449	2,037
Insurance expense		2,331	2,135
Water usage expenses		2,062	2,351
Social expenditures		852	1,668
Loss on disposal of property, plant and equipment and investments		614	189
Other expenses	22	32,600	22,472
Total costs and other deductions		**300,881**	**263,981**
Income from operations	6	**41,847**	**36,866**
Share of loss of associates		(164)	-
Net financing expenses	23	(5,697)	(4,420)
Income before profit tax and minority interest		**35,986**	**32,446**
Total profit tax charge	15	(13,782)	(14,911)
Income before minority interest		**22,204**	**17,535**
Minority interest: share of net result	14	(6,783)	(620)
Net income		**15,421**	**16,915**
Earnings per ordinary and preference share – basic and diluted (in Russian Roubles)	24	0.36	0.39

Chairman of the Management Board — Chubais A.B.

Financial Director — Zhurba D.G.

26 October 2004

RAO UES Group

Consolidated Interim Cash Flow Statement for the six months ended 30 June 2004

(in millions of Russian Roubles)

	Six months ended 30 June 2004	Six months ended 30 June 2003
CASH FLOW FROM OPERATING ACTIVITIES:		
Income before profit tax	**35,986**	**32,446**
Adjustments to reconcile income before profit tax to net cash provided by operations:		
Depreciation and property, plant and equipment impairment	33,574	30,048
Doubtful debtors expense	3,449	2,037
Interest and gain on restructuring accounts payable and taxes payable	6,411	4,799
Share of loss of associates, before profit tax	164	-
Loss on disposal of property, plant and equipment and investments	614	189
Adjustment for non-cash investing activities	(114)	(5,058)
Other	-	(3)
Operating cash flows before working capital changes and profit tax paid	**80,084**	**64,458**
Working capital changes:		
Increase in accounts receivable and prepayments	(19,753)	(15,004)
(Increase) / decrease in other current assets	496	69
Decrease in loans issued	-	1,909
Decrease / (increase) in inventories	623	(815)
Increase in other non-current assets	(5,984)	(4,138)
Increase in accounts payable and accrued charges	1,172	1,008
Increase / (decrease) in taxes payable, other than profits tax	712	(1,502)
Decrease in other non-current liabilities	(5,504)	(1,081)
Profit tax paid (cash)	(15,504)	(13,107)
Profit tax paid (non-cash)	(257)	(132)
Net cash provided by operating activities	**36,085**	**31,665**
CASH FLOW FROM INVESTING ACTIVITIES:		
Additions to property, plant and equipment	(29,715)	(23,018)
Proceeds from sale of property, plant and equipment	3,226	1,093
Purchases of investments, net	(197)	(81)
Net cash used for investing activities	**(26,686)**	**(22,006)**
CASH FLOW FROM FINANCING ACTIVITIES:		
Proceeds from issuance of current debt	95,375	73,669
Proceeds from issuance of non-current debt	5,964	335
Repayment of debt	(98,947)	(79,907)
Interest paid	(3,417)	(3,872)
Dividends paid to RAO UES shareholders	-	(12)
Dividends paid by Group to minority interest shareholders	(231)	(189)
Proceeds from share issuance	27	512
Proceeds from treasury shares, net	-	1,442
Net cash used for financing activities	**(1,229)**	**(8,022)**
Increase in cash and cash equivalents	**8,170**	**1,637**
Cash and cash equivalents at the beginning of the period	**31,978**	**17,569**
Cash and cash equivalents at the end of the period	**40,148**	**19,206**

Chairman of the Management Board Chubais A.B.

Financial Director Zhurba D.G.

26 October 2004

RAO UES Group

Consolidated Interim Statement of Changes in Shareholders' Equity for the six months ended 30 June 2004

(in millions of Russian Roubles)

	Ordinary share capital	Preference share capital	Treasury shares	Retained earnings and fair value reserve	Total shareholders' equity
At 1 January 2003	147,439	7,667	(770)	412,079	566,415
Net income	-	-	-	16,915	16,915
Dividends	-	-	-	(1,988)	(1,988)
Change in fair value of available-for-sale investments	-	-	-	467	467
Change in treasury shares, net	-	-	409	729	1,138
At 30 June 2003	147,439	7,667	(361)	428,202	582,947
At 1 January 2004	147,439	7,667	(355)	432,553	587,304
Net income	-	-	-	15,421	15,421
Dividends	-	-	-	(2,399)	(2,399)
Change in fair value of available-for-sale investments	-	-	-	(106)	(106)
Translation differences	-	-	-	(26)	(26)
At 30 June 2004	147,439	7,667	(355)	445,443	600,194

Chairman of the Management Board — Chubais A.B.

Financial Director — Zhurba D.G.

26 October 2004

Note 1: The Group and its operations

The Russian Open Joint Stock Company for Energy and Electrification Unified Energy System of Russia ("RAO UES") was created on 31 December 1992 following the privatisation of certain electricity power generation, transmission and distribution assets formerly under the control of the Ministry of Energy of the Russian Federation. Nuclear generation stations were not transferred to RAO UES.

The RAO UES Group (the "Group") consists of RAO UES and its related subsidiaries and associates as at 30 June 2004. Principal subsidiaries are disclosed in Note 5. The operations of all generating facilities are co-ordinated by the Central Dispatch Centre ("CDC") and Regional Dispatch Centres, which are all under the control of the Group, in order to meet system requirements in an efficient manner.

All member companies of the Group with the exception of foreign subsidiaries are incorporated under the laws of the Russian Federation (the "state").

The Group performs the following major activities:

- ***High voltage transmission:*** The high voltage transmission network connects all but a few regions of the Russian Federation. RAO UES charges a transmission fee to users of the network and, together with the Federal Grid Company (a 100 percent owned subsidiary of RAO UES), maintains this network. The CDC, a 100 percent owned subsidiary of RAO UES, is responsible for system dispatch and the functioning of the Federal Wholesale Market of Electricity and Capacity ("FOREM");

- ***Regional generation and distribution:*** RAO UES has ownership interests in more than 70 regional power companies ("Energos"), responsible for the generation, distribution and sale of heat and electricity. These ownership interests range from 47 percent to 100 percent; and

- ***Stand-alone electricity generation:*** Major generation stations produce electricity and sell it via FOREM. The majority of these sales are within the Group.

At 30 June 2004, the number of employees of the Group was approximately 521,000 (31 December 2003: 557,000).

RAO UES's registered office is located at bld. 3, 101 Vernadskogo prospect, 119526, Moscow, Russia.

RAO UES also prepares annual parent company stand-alone financial statements in accordance with International Financial Reporting Standards ("IFRS").

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

Whilst there have been improvements in the economic trends, the future economic direction of the Russian Federation is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the government, together with tax, legal, regulatory, and political developments.

Relations with the state and current regulation. At 30 June 2004, the Russian Federation owned 52.7 percent of RAO UES, which represents 55.0 percent of the ordinary shares issued. As discussed in Note 13, only ordinary shares have voting rights. The Group's customer base 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 Energy Commission ("FEC"), with respect to its wholesale energy sales, and by the Regional Energy Commissions ("RECs"), with respect to its retail electricity and heat sales. Tariffs which Group entities may charge for sales of electricity and heat are governed both by regulations specific to the electricity and heat industry and by regulations applicable to natural monopolies. As a condition to privatisation in 1992, the government of the Russian Federation imposed an obligation on Group entities to provide connection for the supply of electricity and heating to customers in the Russian Federation.

Note 1: The Group and its operations (continued)

As described above and in Notes 2 and 26, the government's economic, social and other policies could have material effects on the operations of the Group.

Regulatory issues and sector restructuring. The Russian electric utilities industry in general and the Group in particular are presently undergoing a reform process designed to introduce competition into the electricity sector and to create an environment in which the Group and its successor companies can raise the capital required to maintain and expand current capacity. The regulatory framework governing the process of reforming the Russian Federation electric utilities industry and the functioning of the industry, both during the transition period and subsequent to the completion of reforms, is set forth in the following legislation: Federal Law No.35-FZ of 26 March 2003 "On the Electric Utilities of the Russian Federation" and Federal Law No.36-FZ of 26 March 2003 "On the Specifics of the Functioning of Electric Utilities During the Transition Period and the Introduction of Amendments to Certain Russian Federation Legislative Acts and the Invalidation of Certain Russian Federation Legislative Acts in Connection with the Adoption of the Law "On the Electric Utilities of the Russian Federation".

- In April 2003, legislation underlying the electric utilities reform effort took effect. This legislative package, consisting of six laws drafted by the Russian Federation government, defines the key areas in the industry reform program, as well as the terms and conditions under which electric utilities will function both during the transition period and following the reforms.

- At the present stage, bills are being drafted for the specific legislative acts envisioned under the aforementioned laws on electric utilities reform according to the action plan related to electric utilities reform and adopted by the resolution of the Russian Federation government of 17 July 2004 No 966-r (p). RAO UES has been playing an active role in drafting these parts of legislation.

- Early September 2003 the Russian Federation government issued Resolution No. 1254-r (p) approving the structures of generating companies in the wholesale electricity market (WGC). According to the aforementioned resolution 10 generating companies (4 based on hydro generating power plants and 6 based on heat generating power plants), which will include the electric power plants owned by OAO RAO UES and its subsidiaries, will be established.

- In September-October of 2004 the Board of Directors of RAO UES at its meetings approved participation of RAO UES in WGC-5 and WGC-3.

- In October 2003, the Russian Federation government issued Resolution No. 643 "On the Rules for the Wholesale Electricity (Power) Market during the Transition Period". According to the rules adopted, there will be two sectors within the Federal Wholesale Electricity (Power) Market: regulated trading sector and free trading sector. Within the free trading sector, electricity suppliers will be able to sell electricity generated with the use of facilities and equipment accounting for 15 percent of their working capacity. Since November 2003, the non-commercial partnership "Trade System Administrator of the Wholesale Electricity Market", in accordance with the rules for the wholesale electricity (power) market during the transition period, has been holding electricity bidding in the free trading sector. According to the laws underlying the electric utilities reform, subsequently free trading will be extended over the whole volume of trading.

- The Federal Grid Company – OAO Federal Grid Company of Unified Energy System ("FGC") – was established in June 2002, as a wholly-owned subsidiary of RAO UES, to manage the transmission of electricity through the use of transmission assets received or earmarked for receipt from RAO UES and its subsidiaries.

- The System Operator – OAO System Operator-Central Dispatch Unit of Unified Energy System ("SO-CDU") – was established in June 2002 to perform electricity dispatch functions within the unified electricity system of the Russian Federation through the use of assets received or earmarked for receipt from RAO UES and its subsidiaries.

- On 29 May 2003 the Board of Directors of RAO UES has approved a Concept of the Group's strategy for the period from 2003 through 2008. This document provides a detailed description of the major changes that are planned to take place in the Group during the electric utilities reform program.

Note 1: The Group and its operations (continued)

- At the end of December 2003, the Russian Federation Government issued Directive #1939-p, which set out the procedure for establishing 7 interregional trunk grid companies, to be incorporated by the Russian Federal Property Fund (ownership interest – 85%) and FGC (ownership interest – 15%).
- All the individual Energos that are subject to reform have developed their respective reform plans and submitted them to RAO UES. At present, these reform plans are being discussed, agreed and approved by the management bodies of RAO UES and the government bodies.
- On 23 April 2004, the Board of Directors of RAO UES approved the incorporation of 14 territorial generating companies (TGC). It is planned that these companies will ultimately own power plants, currently owned by RAO UES subsidiaries.
- The Board of Directors of RAO UES at its meeting on September 3, 2004 approved creation of TGC-9 and TGC-14 through establishment of wholly owned subsidiaries of RAO UES Rossii and transfer to the said subsidiaries of generating assets of relevant regional companies on a lease basis.
- As at 26 October 2004, 36 subsidiaries of RAO UES have held General shareholders meeting at which plans for reorganization have been approved.

At this time, the impact of the industry changes on both the financial results and position of the Group cannot be readily assessed because the specific, detailed mechanisms to effect the restructuring are still being determined. Accordingly, except as noted in Note 19, no provision has been recognised for the effects of the restructuring process.

Note 2: Financial condition

At 30 June 2004, the Group's current assets exceeded its current liabilities by Russian Roubles ("RR") 18,844 million (at 31 December 2003 the Group's current liabilities exceeded its current assets by RR 812 million). Since 2000, the Group has improved its financial position, largely through better cash collections and the restructuring of trade and tax liabilities to long term.

The effects of the restructuring of accounts and taxes payable are described in Notes 17, 19 and 20. However, there still remains a significant amount of uncollected accounts receivable from earlier periods. Management has continued its collection and restructuring efforts to reduce the outstanding balances. There is legislation enabling the Group to cut off non-payers, but this is only possible to a certain extent due to strategic and political factors. Federal, municipal and other governmental organisations make up a significant portion of the debtor balance as at 30 June 2004. The Group has provided against doubtful accounts receivable, as further described in Notes 9 and 11.

The Group is affected by government policy through control of tariffs and other factors. The RECs do not always permit tariff increases in line with increases in the Group's costs and thus some tariffs are insufficient to cover all the costs of generation and distribution. Moreover, these tariffs consider costs only on a Russian statutory basis and, accordingly, exclude additional costs recognised under an IFRS basis of accounting. As a result, tariffs do not consistently allow for an adequate return on investment and currently do not provide sufficient funds for the full replacement of property, plant and equipment. Furthermore, the Group also experiences difficulties raising finance for the necessary investment in generation, transmission and distribution assets.

Note 2: Financial condition

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

- introduction of improved financial budgeting procedures; a strong focus on timely cash collection of current and old debtor balances; restructuring of liabilities for repayment over a longer period;
- discussions with strategic investors, and identification and assessment of projects requiring investment funds;
- negotiations with federal and regional governments and regulators for real increases in tariffs to support adequate long term investment into the Group's generation, transmission and distribution assets; and
- active participation in the restructuring of the electricity sector (see Note 1).

Management believes that ultimately a stable regulatory regime and a competitive power market will be put in place such that the Group and its successors will be able to raise needed capital to sustain the business. However, there can be no assurance in this regard.

Note 3: Basis of presentation

These consolidated financial statements have been prepared in accordance with, and comply with, International Financial Reporting Standards, including International Accounting Standards and Interpretations issued by the IASB ("IFRS").

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

The preparation of consolidated financial statements in accordance with IFRS requires management to make prudent estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates have principally been made in respect of the impairment provision on property, plant and equipment, deferred profits taxes, allowance for doubtful debtors and fair values of financial instruments. Actual results could differ from these estimates.

Inflation accounting. Prior to 1 January 2003 the adjustments and reclassifications made to the statutory records for the purpose of IFRS presentation included the restatement of balances and transactions for the changes in the general purchasing power of the RR in accordance with IAS 29 ("Financial Reporting in Hyperinflationary Economies"). IAS 29 requires that the financial statements prepared in the currency of a hyperinflationary economy be stated in terms of the measuring unit current at the balance sheet date. As the characteristics of the economic environment of the Russian Federation indicate that hyperinflation has ceased, effective from 1 January 2003 the Group no longer applies the provisions of IAS 29. Accordingly, the amounts expressed in the measuring unit current at 31 December 2002 are treated as the basis for the carrying amounts in these financial statements.

Adoption of new and revised standards. With effect from 31 March 2004, the Group has adopted IFRS 3 “Business combinations”(IFRS 3), IAS 36 (revised 2004) “Impairment of assets” (IAS 36) and IAS 38 (revised 2004) “Intangible assets” (IAS 38). The adoption of these standards did not have any impact on the consolidated Financial Statements.

Recent accounting pronouncements. During the period December 2003 to March 2004, the International Accounting Standards Board (“IASB”) revised 17 of its standards and issued 4 new standards. These standards, except for IFRS 3, IAS 36 and IAS 38, are effective for accounting periods commencing on or after 1 January 2005 but may be adopted early. The Group has not early adopted these revised and new standards in preparing these interim financial statements. IFRS 3, IAS 36 and IAS 38 were adopted as described above.

Note 4: Summary of significant accounting policies

Principles of consolidation. The consolidated financial statements comprise the financial statements of RAO UES and the financial statements of those entities whose operations are controlled by RAO UES. Control is presumed to exist when RAO UES controls, directly or indirectly through subsidiaries, more than 50 percent of voting rights. The Group consolidates a number of companies in which the Group owns less than 50 percent of the voting shares. Control exists for such entities on the basis of a dominant shareholding combined with other factors which allow the Group to exercise control.

A significant majority of the principal subsidiary companies described in Note 5 were transferred to RAO UES by the state on and after its incorporation into a joint stock company. These transfers represented a reorganisation of assets under common control and, accordingly, are accounted for in a manner similar to uniting of interests from the date of privatisation of each Group entity.

All material inter-group balances and transactions have been eliminated. Separate disclosure is made of minority interests.

Associated enterprises. Investments in associated enterprises are accounted for using the equity method of accounting, based upon the percentage of ownership held by the Group. Associated enterprises are entities over which RAO UES is presumed to exercise significant influence but which it does not control.

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

Available-for-sale investments principally comprise non-marketable securities, which are not publicly traded or listed on the Russian stock exchange. For these investments, fair value is estimated by reference to a variety of methods including those based on their earnings and those using the discounted value of estimated future cash flows. In assessing the fair value, management makes assumptions that are based on market conditions existing at each balance sheet date. Investments in equity securities that are not quoted on a stock exchange, and where fair value cannot be estimated on a reasonable basis by other means, are stated at cost less impairment losses.

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

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

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

The balance sheets of foreign subsidiaries are translated into Russian Roubles at the exchange rate prevailing at the reporting date. Statements of operations of foreign entities are translated at average exchange rate for the year. Exchange differences arising on the translation of the net assets of foreign subsidiaries are recognised as translation differences and included in shareholders' equity.

(in millions of Russian Roubles)

Note 4: Summary of significant accounting policies (continued)

At 30 June 2004, the official rate of exchange, as determined by the Central Bank of the Russian Federation, between the Russian Rouble and the US Dollar ("US$") was RR 29.03: US$ 1.00 (31 December 2003: RR 29.45: US$ 1.00), between the Russian Rouble and Euro RR 35.29: Euro 1.00 (31 December 2003: RR 36.82: Euro 1.00). Exchange restrictions and currency controls exist relating to converting the Russian Rouble into other currencies. The RR is not freely convertible in most countries outside the Russian Federation.

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

Property, plant and equipment. Property, plant and equipment are stated at depreciated replacement cost, based upon values determined by a third party valuation at 31 December 1997, and adjusted for subsequent additions at cost, disposals and depreciation, and restated for the impact of inflation until 31 December 2002. 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 net selling price 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 statement of operations. An impairment loss recognised in prior years is reversed if there has been a change in the estimates used to determine an asset's recoverable amount.

The amounts determined by the third party valuation represent an estimate of depreciated replacement cost. The third party valuation was performed in order to determine a basis for cost, because the historical accounting records for property, plant and equipment were not readily available. Therefore, this third party valuation is not a recurring feature since it was intended to determine the initial cost basis of property, plant and equipment. The change in carrying value arising from this valuation was recorded directly to retained earnings.

Major renewals and improvements are capitalised and the assets replaced are retired. Maintenance, repairs and minor renewals are expensed as incurred. Minor renewals include all expenditures that do not result in a technical enhancement of an asset beyond its original capability. Gains and losses arising from the retirement of property, plant and equipment are included in the statement of operations as incurred.

During the period of time that is required to complete and prepare the asset for its intended use interest costs on borrowings to finance the construction of property, plant and equipment are capitalised. All other borrowing costs are expensed.

Depreciation on property, plant and equipment is calculated on a straight-line basis over the estimated useful life of the asset when it is put into use. For the property, plant and equipment which was subject to the third party valuation as at 31 December 1997, the depreciation rate applied is based on the estimated remaining useful lives as at the valuation date. The useful lives, in years, of assets by type of facility are as follows:

Type of facility	**Acquired prior to 31 December 1997**	**Acquired subsequent to 31 December 1997**
Electricity and heat generation	3 – 80	20 – 80
Electricity transmission	14 – 40	25 – 40
Electricity distribution	3 – 40	25 – 40
Heating network	3 – 40	20 – 40
Other	8 – 24	10 – 40

Social assets are not capitalized 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.

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

Note 4: Summary of significant accounting policies (continued)

The statement of cash flows has been prepared in accordance with IAS 7 "Cash Flow Statements". However, the Group relies to some extent on non-cash transactions and individual items within operating activities of the statement of cash flows are stated inclusive of both cash and non-cash transactions. Management believes that the benefits of providing individual cash items within operating activities is outweighed by the cost of preparation.

Mutual settlements, barter and non-cash settlements. A portion of sales and purchases is settled by mutual settlements, barter and non-cash settlements. These settlements are generally in the form of direct settlement by goods or services with the final customer, cancellation of mutual balances or through a chain of non-cash transactions involving several companies. Non-cash settlements which are expected to be settled within 12 months are recorded as other current assets. These include "veksels" or "bills of exchange" which are negotiable debt obligations. The receivables and payables recorded in the consolidated balance sheet, that are expected to be settled by mutual settlements, barter or non-cash settlements, reflect management's estimate of the fair value to be received or given up in non-cash settlements.

Accounts receivable and prepayments. Accounts receivable are recorded inclusive of value added taxes which are payable to tax authorities upon collection of such receivables. Trade and other receivables are adjusted for an allowance made for impairment of these receivables. Such an allowance for doubtful debtors 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 allowance is the difference between the carrying amount and the recoverable amount, being the present value of expected cash flows, discounted at the market rate of interest for similar borrowers at the date of origination of the receivables.

Value added tax on purchases and sales. Value added taxes related to sales is payable to tax authorities upon collection of receivables from customers. Input VAT is reclaimable against sales VAT upon payment for purchases. The tax authorities permit the settlement of VAT on a net basis. VAT related to sales and purchases which have not been settled at the balance sheet date (VAT deferred) is recognised in the balance sheet on a gross basis and disclosed separately as a current asset and liability. Where provision has been made for impairment of receivables, impairment loss is recorded for the gross amount of the debtor's balance, including VAT. The related VAT deferred liability is maintained until the debtor is written off for tax purposes.

Inventories. Inventories are valued at the lower of net realisable value and weighted average cost. Provision is made for potential losses on obsolete or slow-moving inventories, taking into account their expected use and future realisable value.

Deferred profit taxes. Deferred profit tax assets and liabilities are calculated in respect of temporary differences using the balance sheet liability method. Deferred profit tax is provided for all temporary differences arising between the tax basis of assets and liabilities and their carrying values for financial reporting purposes. A deferred profit tax asset is recorded only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised. Deferred profit tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates that have been enacted or substantively enacted at the balance sheet date.

Deferred profit tax is not provided for the undistributed earnings of subsidiaries, as the Group requires profits to be reinvested, and only insignificant dividends are declared. Deferred profit tax is provided for the undistributed earnings of associated enterprises.

Accounts payable and accrued charges. Accounts payable are stated inclusive of value added tax which is reclaimable from the tax authorities upon the later of receipt of goods and services or the payment of the associated payable.

If accounts payable are restructured and the fair value of the restructured payable differs by more than ten percent from the original liability, then the fair value of the restructured payable is measured as the present value of the future cash flows discounted at the interest rate available to the Group at the date of the restructuring. The amount of the discount is credited to the statement of operations (net financing expenses) as a gain on restructuring, and the non-current portion of the discounted payable is reclassified to other non-current liabilities. The discount is amortised over the period of the restructuring as an interest expense.

Note 4: Summary of significant accounting policies (continued)

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

Minority interest. Minority interest represents the minority shareholders' proportionate share of the equity and result of operations of the Group's subsidiaries. This has been calculated based upon the minority interests' ownership percentage of these subsidiaries. Specific rights on dissolution for preference shareholders are included in the calculation of minority interests.

Pension and post-employment benefits. In the normal course of business the Group contributes to the Russian Federation state pension scheme on behalf of its employees. Mandatory contributions to the governmental pension scheme are expensed when incurred. Discretionary pensions and other post-employment benefits are included in wages, benefits and payroll taxes in the statement of operations, however, separate disclosures are not provided as these costs are not material.

Environmental liabilities. Liabilities for environmental remediation are recorded where there is a present obligation, the payment is probable and reliable estimates exist.

Revenue recognition. Revenue is recognised on the delivery of electricity and heat and on the dispatch of non-utility goods and services through the end of the period. Revenue amounts are presented exclusive of value added tax.

Revenue is based on the application of authorised tariffs for electricity and heat sales as approved by the regional RECs.

Earnings per share. Preference shares are considered to be participating shares, as their dividend may not be less than that given with respect to ordinary shares. An earnings per share is determined by dividing the net income attributable to ordinary and preference shareholders by the weighted average number of ordinary and preference shares outstanding during the reporting period, excluding the average number of treasury shares held by the Group. Preference shares participate in losses.

Treasury shares. Treasury shares are stated at weighted average cost. Any gains or losses arising on the disposal of treasury shares are recorded directly in shareholders' equity.

Seasonality. Demand for electricity and heat is influenced by both the season of the year and the relative severity of the weather. Revenues from heating are concentrated within the months of October to March. A similar, though less severe, 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.

(in millions of Russian Roubles)

Note 5: Principal subsidiaries

The following are the significant subsidiary enterprises which have been consolidated into the Group's financial statements. All subsidiaries with the exception of foreign companies are incorporated and operate in Russia.

Regional generation and distribution companies

Name	Ownership %	Voting %
Centre		
Astrakhanenergo	49.0	49.0
Belgorodenergo	49.0	65.3
Bryanskenergo	49.0	65.2
Ivenergo	49.7	56.6
Kalugaenergo	52.3	52.3
Kostromaenergo	49.0	65.3
Kurskenergo	49.0	59.5
Lipetskenergo	49.0	49.0
Mosenergo	50.9	50.9
Orelenergo	49.5	60.6
Ryazanenergo	49.0	49.0
Smolenskenergo	48.7	59.3
Tambovenergo	49.0	56.0
Tulenergo	49.0	49.0
Tverenergo	49.0	65.3
Vladimirenergo	49.0	49.0
Volgogradenergo	49.0	61.3
Vologdaenergo	49.0	49.0
Voronezhenergo	49.0	49.0
Yarenergo	47.8	60.3
North-West		
Arkhenergo	49.0	59.1
Karelenergo	100.0	100.0
Kolenergo	49.2	49.2
Komienergo	50.1	50.3
Lenenergo	49.0	57.4
Novgorodenergo	49.0	62.9
Pskovenergo	49.0	49.0
Yantarenergo	100.0	100.0
Middle Volga		
Chuvashenergo	100.0	100.0
Marienergo	64.4	70.1
Mordovenergo	53.1	53.1
Nizhnovenergo	49.0	62.3
Penzaenergo	49.0	49.0
Samaraenergo	49.0	56.3
Saratovenergo	49.0	49.0
Ulyanovskenergo	49.0	49.0

Name	Ownership %	Voting %
South		
Dagenergo	51.3	51.3
Kabbalkenergo	65.3	65.3
Kalmenergo	96.4	96.4
Karachaevo-Cherkesskenergo	100.0	100.0
Kubanenergo	49.0	49.0
Rostovenergo	48.4	62.8
Sevkavkazenergo	49.0	49.0
Stavropolenergo	55.1	71.9
Ural		
Chelyabenergo	49.0	49.0
Kirovenergo	48.2	64.0
Kurganenergo	49.0	49.0
Orenburgenergo	100.0	100.0
Permenergo	49.0	64.4
Sverdlovenergo	49.0	49.0
Tumenenergo	100.0	100.0
Udmurtenergo	49.0	55.4
Siberia		
Altaienergo	54.7	72.2
Buryatenergo	47.0	47.0
Chitaenergo	49.0	62.2
Khakasenergo	100.0	100.0
Krasnoyarskenergo	51.8	66.4
Kuzbassenergo	49.0	49.0
Omskenergo	49.0	60.4
Tomskenergo	52.0	59.9
Tuvaenergo	51.2	99.0
East		
Amurenergo	50.6	57.8
Dalenergo	49.0	65.3
Geotherm	72.6	78.5
Khabarovskenergo	48.5	48.5
Kolymaenergo	93.0	93.0
Kamchatskenergo	49.0	49.0
Magadanenergo	49.0	64.4
Sakhalinenergo	49.0	49.0
Sakhaenergo	47.9	100.0
Yakutskenergo	47.9	56.3

(in millions of Russian Roubles)

Note 5: Principal subsidiaries (continued)

Hydrogenerating companies

Name	Ownership %	Voting %	Name	Ownership %	Voting %
Bureyskaya GES	75.4	76.5	Taimyrenergo	100.0	100.0
Kabbalk GES	81.4	98.0	Volzhskaya GES (Volzhsk)	83.3	83.4
Kamskaya GES	100.0	100.0	Volzhskaya GES (Zhigulevsk)	85.0	85.8
Kaskad Verhnevolzhskih GES	100.0	100.0	Votkinskaya GES	59.8	74.2
Nizhegorodskaya GES	100.0	100.0	Zaramagskie GES	90.0	91.7
Saratovskaya GES	100.0	100.0	Zeiskaya GES	56.9	57.4
Sayano-Shushenskaya GES	78.9	82.8	Zelenchugskie GES	100.0	100.0
Sulakenergo	99.1	99.1			

Thermal generating companies

Name	Ownership %	Voting %	Name	Ownership %	Voting %
Berezovskaya GRES –1	100.0	100.0	Nevinomysskaya GRES	100.0	100.0
Cherepetskaya GRES	55.8	55.8	North-West Station	68.2	75.3
Dzerzhinskaya TETS	49.0	100.0	Novocherkasskaya GRES	100.0	100.0
Gusinoozerskaya GRES	100.0	100.0	Novomoskovskaya GRES	49.0	100.0
Experimentalnaya TETS	74.9	100.0	Pechorskaya GRES	51.0	51.0
Kaliningradskaya TETS –2	87.0	87.0	Permskaya GRES	100.0	100.0
Kharanorskaya GRES	100.0	100.0	Pskovskaya GRES	50.0	50.0
Kirishskaya GRES	100.0	100.0	Ryazanskaya GRES	100.0	100.0
Konakovskaya GRES	51.0	51.0	Shekinskie PGU	92.1	98.9
Kostromskaya GRES	51.0	51.0	Sochinskaya TETS	100.0	100.0
Krasnoyarskaya GRES –2	100.0	100.0	Stavropolskaya GRES	51.0	51.0
Kuban GRES	79.8	99.9	Troitskaya GRES	100.0	100.0
Lutek	56.3	56.3			

Construction companies

Name	Ownership %	Voting %	Name	Ownership %	Voting %
Boguchanskaya GES	64.2	68.0	Chirkeigesstroi	100.0	100.0
Bureyagesstroy	100.0	100.0			

Other

Name	Ownership %	Voting %	Name	Ownership %	Voting %
Central Dispatch Centre	100.0	100.0	Kaluzhskaya Sales Company	52.3	52.3
Insurance company LIDER	100.0	100.0	Federal Grid Company	100.0	100.0
System Operator	100.0	100.0	Centre of Settlement Optimisation	100.0	100.0
Inter RAO UES	60.0	60.0	Media-Holding REN-TV	70.0	70.0
Energy Centre	75.0	75.0	Engineering Centre	100.0	100.0

(in millions of Russian Roubles)

Note 5: Principal subsidiaries (continued)

Foreign companies

Name	Ownership %	Voting %	Country
RAO Nordic	60.0	100.0	Finland
Telasi	45.0	75.0	Georgia
Mtkvari	60.0	100.0	Georgia
Transenergy	30.0	50.0	Georgia
Silk Road	60.0	100.0	Netherlands
Gardabani	60.0	100.0	Netherlands
Georgia	60.0	100.0	Netherlands
MEK	54.0	100.0	Armenia

The Group controls Centre for Assistance in Restructuring the Electricity Sector, a non-commercial partnership.

Differences between ownership interest and voting interest normally represent the effect of preference shares. Primarily RAO UES does not hold any preference shares of its subsidiaries. Such preference shares do not have any voting rights, unless dividends have not been declared fully at the Annual shareholders' meeting.

In June 2003, RAO Nordic, a Group entity, founded ZAO MEK, an entity located in Armenia. RAO Nordic owns a 90 percent interest in this entity. In September 2003, ZAO MEK purchased assets of ZAO Sevan-Razdansky Kaskad, a cascade of hydroplants located in Armenia, for a fair value consideration of RR 1,172 million (US$ 25 million payable immediately and EUR 17 million payable along with related interest over a period of 32 years commencing in 2009). The Group has settled the US$ 25 million payment to the seller by assuming the liability of ZAO Armyanskaya AS, a nuclear power plant, located in Armenia ("Armenian NPP"), owned by the government of Armenia, which is also the ultimate owner of the assets purchased, to a supplier of nuclear fuel. The assumed liability is payable in equal installments over a period of 5 years commencing in 2004.

The assets arising from the acquisition are as follows:	
Accounts receivable and prepayments	43
Other current assets	52
Property, plant and equipment	1,077
Fair value of assets acquired	**1,172**

The above acquisition was accounted for under the purchase method of accounting. The purchase price of the foreign acquisition was translated at the exchange rate in effect at the date of acquisition.

In May 2003, RAO Nordic, a Group entity, concluded an agreement to settle a separate liability of Armenian NPP to another supplier of nuclear fuel for the amount of RR 490 million (US$ 15.7 million). RAO Nordic will receive this amount back from Armenian NPP along with interest during two years commencing in June 2003. As of 30 June 2004 the outstanding recoverable balance of RR 245 million is included within other current assets.

Inter RAO UES and the government of Armenia have entered into a contract in the respect of the Armenian NPP and will be entitled to the higher of 25 percent of that plant's annual net income during the period of 5 years commencing in September 2003 or US$ 0.1 million annually as a management fee (in the case of annual dividend distribution).

In August 2003, the Group acquired 100 percent of the shares of AES Silk Road, AES Gardabani and AES Georgia, all holding companies based in the Netherlands, from the AES Group. In addition, amounts receivable by the AES Group from the above companies amounting to RR 15,923 million (US$ 522 million) were acquired by the Group. The total consideration paid in cash was RR 704 million (US$ 23 million).

The above holding companies were, in their turn, the owners of shares in certain entities located in Georgia: 75 percent of AES Telasi, an entity which holds electricity distribution assets, 100 percent of OOO AES Mtkvari, an entity which holds electricity and heat generation assets; 50 percent of AES Transenergy, an entity which exports energy; AES Georgia was also the owner of the management rights of Khramesy 1 and 2 hydrogeneration plants.

(in millions of Russian Roubles)

Note 5: Principal subsidiaries (continued)

The assets and liabilities arising from the acquisition are as follows:	
Cash and cash equivalents	53
Accounts receivable and prepayments	1,247
Other current assets	448
Property, plant and equipment	613
Other non-current assets	258
Accounts payable and accrued charges	(221)
Other current liabilities	(343)
Non-current debt	(97)
Other non-current liabilities	(153)
Minority interest	(1,101)
Fair value of net assets acquired	**704**
Less: cash and cash equivalents in subsidiary acquired	(53)
Cash flow on acquisition, net of cash acquired	**651**

The acquisition was accounted for under the purchase method of accounting. The results of operations of the acquired businesses were included in the consolidated financial statements as of the respective date of acquisition. The purchase price of the foreign acquisition was translated at the exchange rates in effect as the respective date of acquisition.

During the six months ended 30 June 2004 there were certain other changes in RAO UES' ownership percentage of several of its subsidiaries, which had an immaterial impact on the statement of operations.

Note 6: Segment information

Primary reporting segments – business segments. The Group is organised into four main business segments:

- ***"Transmission segment"*** this segment principally comprises RAO UES, FGC, SO-CDU and CDC, which maintain and operate the high voltage electricity transmission grid and perform electricity dispatch functions. Transmission fees are set by the FEC;

- ***"Energos segment"*** consists of regional electricity and heat generation and distribution. The majority of electricity generated by energos is sold within the regions in which the energo operates at tariffs set by RECs. Certain energos have surplus generation and sell electricity via FOREM. Tariffs in FOREM are set by the FEC;

- ***"Hydro and thermal generating stations segment"*** consists of entities that produce and sell electricity to energos through FOREM, at tariffs set by the FEC; and

- ***"Unallocated"*** consists of numerous insignificant segments including construction, and export generation and sales.

(in millions of Russian Roubles)

Note 6: Segment information (continued)

Six months ended 30 June 2004	Transmission	Energos	Hydro and thermal generating stations	Unallocated	Consolidation adjustments	Total
Gross revenues	28,671	325,803	36,701	15,935	-	407,110
Intra-group revenues	(25,319)	(7,293)	(25,309)	(6,461)	-	(64,382)
Net revenues	3,352	318,510	11,392	9,474	-	342,728
Segment income	13,311	25,389	4,542	(1,395)	-	41,847
Capital expenditures	6,492	17,980	7,587	1,397	-	33,456
Depreciation and property, plant and equipment impairment	6,928	22,369	3,289	988	-	33,574
Doubtful debtors expense / (release)	2	1,832	417	1,198	-	3,449

Six months ended 30 June 2003	Transmission	Energos	Hydro and thermal generating stations	Unallocated	Consolidation adjustments	Total
Gross revenues	33,298	287,019	31,271	17,543	-	369,131
Intra-group revenues	(31,898)	(4,747)	(25,352)	(6,287)	-	(68,284)
Net revenues	1,400	282,272	5,919	11,256	-	300,847
Segment income / (loss)	15,600	17,554	2,548	1,189	(25)	36,866
Capital expenditures	4,183	13,709	6,504	4,106	-	28,502
Depreciation	3,933	22,009	3,053	1,053	-	30,048
Doubtful debtors expense / (release)	2	1,662	(239)	612	-	2,037

As at 30 June 2004	Transmission	Energos	Hydro and thermal generating stations	Unallocated	Consolidation adjustments	Total
Segment total assets	151,945	753,388	154,544	117,369	(64,313)	1,112,933
Associates	-	-	-	32	-	32
Total assets	151,945	753,388	154,544	117,401	(64,313)	1,112,965
Segment liabilities	5,181	144,566	40,762	148,412	(51,527)	287,394
Total liabilities	5,181	144,566	40,762	148,412	(51,527)	287,394

As at 31 December 2003	Transmission	Energos	Hydro and thermal generating stations	Unallocated	Consolidation adjustments	Total
Segment total assets	148,721	739,889	140,723	112,530	(54,518)	1,087,345
Associates	-	-	-	196	-	196
Total assets	148,721	739,889	140,723	112,726	(54,518)	1,087,541
Segment liabilities	4,353	144,554	33,033	136,790	(38,180)	280,550
Total liabilities	4,353	144,554	33,033	136,790	(38,180)	280,550

(in millions of Russian Roubles)

Note 6: Segment information (continued)

Secondary reporting segments – geographical segments. The Group operates in seven geographical areas within the Russian Federation. These geographical areas correspond to the regions established for system operation. Group entities have been aggregated within these geographical areas based on the area where their assets are located, with the exception of the Transmission segment. The transmission grid, owned by RAO UES and FGC, is located throughout the territory of the Russian Federation, but is recorded in the books of these enterprises without details of geographic location. Accordingly, it is not practicable to split these assets on a geographical basis. The Group's assets generate revenues primarily within the geographical region where they are located.

	Revenue		Total assets		Capital expenditures	
	Six months ended 30 June 2004	Six months ended 30 June 2003	30 June 2004	31 December 2003	For six months ended 30 June 2004	For six months ended 30 June 2003
Transmission segment	28,671	33,298	151,945	148,721	6,492	4,183
Centre	108,582	92,554	253,146	252,458	6,125	4,954
North-West	39,927	34,796	88,147	82,194	4,205	2,060
Urals	79,358	70,679	188,303	187,967	3,030	2,231
Siberia	41,851	38,126	129,944	127,791	3,385	2,826
Middle Volga	35,579	32,042	69,090	63,875	1,692	1,048
East	33,782	31,366	113,292	107,162	3,873	5,763
South	24,937	22,123	69,193	65,558	3,498	2,026
	392,687	354,984	1,063,060	1,035,726	32,300	25,091
Unallocated	14,423	14,147	114,218	106,333	1,156	3,411
Consolidation adjustments	(64,382)	(68,284)	(64,313)	(54,518)	-	-
Total	342,728	300,847	1,112,965	1,087,541	33,456	28,502

Note 7: Related parties

In May 2003, the Group acquired 25 percent of the share capital of a new entity JSC "Rossiskiye kommunalniye sistemy" (RKS). RKS is incorporated and operates in Russia. The entity was set up with the purpose to provide local utility services to customers.

The following transactions were carried out with RKS, the majority of which are based on tariffs set by the REC:

	Six months ended 30 June 2004
Electricity revenues	441
Heating revenues	1,424
Electricity and heat distribution expense	43

(in millions of Russian Roubles)

Note 7: Related parties (continued)

Directors' compensation. Compensation is paid to members of the Management Board of RAO UES for their services in full time management positions. The compensation is made up of a contractual salary, non-cash benefits, and a performance bonus depending on results for the year according to Russian statutory financial statements. The compensation is approved by the Board of Directors. Discretionary bonuses are also payable to members of the Management Board, which are approved by the Chairman of the Managing Board according to his perception of the value of their contribution.

Fees, compensation or allowances to the members of the Board of Directors for their services in that capacity and for attending Board meetings are paid depending on results for the year. Under the Russian legislation, fees, compensation or allowances to the members of the Board of Directors, being government employees, are transferred to the federal budget.

Remunerations of members of the Board of Directors for the six months ended 30 June 2004 and 2003, amounted to RR 257 million and RR 268 million, respectively. Remuneration of members of the Management Board, amounted to RR 92 million and RR 56 million for the six months ended 30 June 2004 and 30 June 2003, respectively.

Note 8: Property, plant and equipment

Appraised value or cost

	Electricity and heat generation	Electricity transmission	Electricity distribution	Heating networks	Construction in progress	Other	Total
Opening balance as at 31 December 2003	750,577	231,671	709,576	131,059	205,590	242,418	2,270,891
Additions	1,378	711	510	30	29,075	1,752	33,456
Transfers	10,205	9,286	5,388	1,326	(31,677)	5,472	-
Disposals	(2,716)	(58)	(1,846)	(582)	(2,303)	(4,214)	(11,719)
Closing balance as at 30 June 2004	759,444	241,610	713,628	131,833	200,685	245,428	2,292,628

Accumulated depreciation (including impairment)

	Electricity and heat generation	Electricity transmission	Electricity distribution	Heating networks	Construction in progress	Other	Total
Opening balance as at 31 December 2003	(464,075)	(131,953)	(506,686)	(94,965)	(25,595)	(175,438)	(1,398,712)
Charge for the period	(8,336)	(4,930)	(7,600)	(2,295)	(1,721)	(8,692)	(33,574)
Transfers	(1,277)	(242)	(171)	(114)	2,505	(701)	-
Disposals	1,501	73	1,572	584	84	3,485	7,299
Closing balance as at 30 June 2004	(472,187)	(137,052)	(512,885)	(96,790)	(24,727)	(181,346)	(1,424,987)
Net book value as at 30 June 2004	287,257	104,558	200,743	35,043	175,958	64,082	867,641
Net book value as at 31 December 2003	286,502	99,718	202,890	36,094	179,995	66,980	872,179

Construction in progress represents the carrying amount of property, plant and equipment that has not yet been put into operation, including generating stations under construction.

(in millions of Russian Roubles)

Note 8: Property, plant and equipment (continued)

Depreciation is charged once an asset is available for service.

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

The assets transferred to the Group upon privatisation did not include the land on which the Group's buildings and facilities are situated. The Group has the option to purchase this land upon application to the state registrator body or to continue occupying this land under a rental agreement. Russian legislation does not specify an expiry date to this option. As at 30 June 2004, the majority of the Group's companies have not filed any application to exercise the purchase option.

A portion of property, plant and equipment additions has been settled through mutual settlement, barter and other non-cash means. Non-cash transactions in respect of property, plant and equipment are:

	Six months ended 30 June 2004	Six months ended 30 June 2003
Non-cash acquisitions	3,741	5,483
Non-cash proceeds from the sale of property, plant and equipment	580	543

The majority of the non-cash acquisitions related to construction in progress.

Impairment. For the six months ended 30 June 2004, management assessed the adequacy of the existing impairment provision and concluded that an additional impairment charge was needed due to changes in estimated future net cash flows related to certain fixed assets and construction in progress. An additional impairment provision of RR 2,597 mln was recognised.

Management has used various assumptions in the calculation of the recoverable value of property, plant and equipment. Variations in these assumptions may give rise to a significantly different amount for the impairment provision. In management's opinion, the existing provision represents the best estimate of the impact of impairment as a result of the current economic conditions in the Russian Federation.

Included in the impairment provision is RR 19,555 million related to items recorded as construction in progress, which currently are not planned to be completed and are therefore fully impaired.

Note 9. Other non-current assets

	30 June 2004	31 December 2003
Available-for-sale investments (carried at cost)	8,099	6,962
Available-for-sale investments (carried at fair value)	2,589	2,589
Advances to contractors	15,890	10,830
Restructured trade receivables (Net of allowance for doubtful debtors of RR 4,518 million as at 30 June 2004 and RR 5,051 million as at 31 December 2003)	3,453	2,936
Other (Net of allowance for doubtful debtors of RR 865 million as at 30 June 2004)	3,290	2,883
	33,321	26,200

(in millions of Russian Roubles)

Note 10: Cash and cash equivalents

	30 June 2004	31 December 2003
Cash at bank and in hand	31,069	19,982
Cash equivalents	7,610	9,856
Foreign currency accounts	1,469	2,140
	40,148	31,978

Cash equivalents comprise short term investments in bank promissory notes and certificates of deposit.

Note 11: Accounts receivable and prepayments

	30 June 2004	31 December 2003
Trade receivables	51,464	43,590
(Net of allowance for doubtful debtors of RR 39,713 million as at 30 June 2004 and RR 40,527 million as at 31 December 2003)		
Value added tax recoverable	23,530	24,445
Advances to suppliers and prepayments	19,158	14,577
Receivables from associates	280	151
Other receivables	27,212	22,577
(Net of allowance for doubtful debtors of RR 7,436 million as at 30 June 2004 and RR 6,534 million as at 31 December 2003)		
	121,644	105,340

At 30 June 2004 and 31 December 2003, the above other receivables balance included RR 11,250 million and RR 7,135 million of tax prepayments, respectively, which are to be settled against future tax liabilities.

Management has determined the allowance for doubtful debtors based on specific customer identification, customer payment trends, subsequent receipts and settlements and analyses of expected future cash flows. Based on the expected collection rate, discount rates of 16–25 percent have been used in the estimate of fair value of future cash flows. The effects of discounting are reflected in the doubtful debtor allowance and expense. The management of the Group believes that Group entities will be able to realise the net receivable amount through direct collections and other non-cash settlements.

Certain trade receivables have been restructured and as a result are due to be realised more than one year from the balance sheet date (see Note 9). The loss on restructuring is included in doubtful debtors expense.

For the six months ended 30 June 2004: approximately 6 percent (the six months ended 30 June 2003: 11 percent) of the Group's accounts receivables were settled via non-cash settlements.

(in millions of Russian Roubles)

Note 12: Inventories

	30 June 2004	31 December 2003
Materials and supplies	26,651	24,443
Fuel production stocks	13,605	16,858
Other inventories	1,852	1,430
	42,108	42,731

The above inventory balances are recorded net of an obsolescence provision of RR 2,020 million and RR 2,036 million as at 30 June 2004 and 31 December 2003, respectively.

At 30 June 2004 and 31 December 2003, the inventory balance included RR 17,209 million and RR 18,200 million, respectively, of inventory pledged as collateral under loan agreements.

Note 13: Shareholders' equity

Share Capital

	Number of shares issued and fully paid	30 June 2004	31 December 2003
Ordinary shares	41,041,753,984	147,439	147,439
Preference shares	2,075,149,384	7,667	7,667
		155,106	155,106

The authorised number of ordinary and preference shares are 47,509,289,488 and 2,075,149,384 respectively, both with a nominal value per share of 0.5 Russian Roubles.

Ordinary shares and preference shares. Preference shares have no right of conversion or redemption, but are entitled to a minimum annual dividend of 10 percent of net statutory profit. In total the preference dividend may not be less than the ordinary dividend and is not cumulative. Preference shares carry no voting rights except when dividends on preference shares have not been declared fully at the Annual Shareholders' meeting. In liquidation preference shareholders are first paid any declared unpaid dividends and then the nominal value of the shares ("liquidation value"). Following this, preference shareholders participate equally in the distribution of remaining assets with ordinary shareholders.

On 7 May 1998 the law number 74-FZ "On the Peculiarities of Share Distribution of UES" was signed by the President of the Russian Federation. This law stipulates that a minimum of 51 percent of voting shares in RAO UES be held by the government of the Russian Federation and that foreign investors are limited to owning not more than 25 percent of the voting shares of the company. The practical implications of this foreign ownership limitation for RAO UES or its shareholders are unclear.

Dividends. The annual statutory accounts of the parent company, RAO UES, are the basis for the annual profit distribution and other appropriations. The specific Russian legislation identifies the basis of distribution as the net profit for the year. For 2003, the statutory profit for the parent company, RAO UES, as reported in the published statutory reporting forms, was RR 24,605 million. However this legislation and other statutory laws and regulations dealing with the distribution rights are open to legal interpretation and, accordingly, management believes at present it would not be appropriate to disclose an amount for the distributable reserves in these financial statements.

A dividend was declared in 2004 in respect of the year ended 31 December 2003 of RR 0.0469 per ordinary share (in 2003 in respect of 2002: RR 0.0337 per ordinary share) and RR 0.2283 per preference share (in 2003 in respect of 2002: RR 0.2916 per preference share).

(in millions of Russian Roubles)

Note 13: Shareholders' equity (continued)

Fair value reserve. The fair value reserve, relating to the changes in the fair value of available-for-sale investments, at 30 June 2004 was a debit of RR 4,910 million (31 December 2003: a debit of RR 4,804 million), and is included in retained earnings and fair value reserve.

Treasury shares. The Group periodically purchases and sells treasury shares. Treasury shares as at 30 June 2004 represent 49,138,221 (31 December 2003: 49,138,221) ordinary shares and 16,768,863 (31 December 2003: 16,768,863) preference shares.

	Cost as at 31 December 2003	Purchases and disposals, net	Cost as at 30 June 2004
Ordinary shares	300	-	300
Preference shares	55	-	55
	355	-	355

Note 14: Minority interest

	Six months ended 30 June 2004	Six months ended 30 June 2003
Opening balance, beginning of year	219,687	223,981
Share of net result	6,783	620
Acquisitions and changes in Group structure	1,038	618
Dividends	(2,131)	(1,824)
Closing balance, end of period	225,377	223,395

Note 15: Profit tax

Profit tax expense

	Six months ended 30 June 2004	Six months ended 30 June 2003
Current profit tax charge	(13,028)	(10,825)
Deferred profit tax charge	(754)	(4,086)
Total profit tax charge	(13,782)	(14,911)

During the six months ended 30 June 2004 most members of the Group were subject to profit tax rates of 24 percent on taxable profit.

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

(in millions of Russian Roubles)

Note 15: Profit tax (continued)

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

	Six months ended 30 June 2004	Six months ended 30 June 2003
Income before profit tax	**35,986**	**32,446**
Theoretical profit charge at an average statutory tax rate of 24 percent	(8,637)	(7,787)
Tax effect of items which are not deductible or assessable for taxation purposes:		
Tax interest and penalties release/(charge)	168	(226)
Other non-deductible and non-taxable items, net	(4,143)	(2,283)
Effect of statutory revaluation on tax base	594	(4,842)
Non-recognised deferred tax assets movements	(1,221)	2,239
Other	(543)	(2,012)
Total profit tax charge	(13,782)	(14,911)

In June 2002 RAO UES established a wholly-owned subsidiary FGC. RAO UES transferred property, plant and equipment into the charter capital of this subsidiary. In 2003 and 2004, RAO UES continued transferring property, plant and equipment into the charter capital of FGC. In 2003, RAO UES established Saratovskaya GES and Nizhegorodskaya GES, two wholly owned subsidiaries to perform electricity generation as separate legal entities. In 2004, Tulaenergo established a wholly-owned subsidiary Novomoskavskaya GRES. The value of the property, plant and equipment transferred by RAO UES and Tulaenergo was determined by a third party valuer. This valuation is used for Russian statutory and tax accounting purposes. Consequently, included within the effect of statutory revaluation for the six months ended 30 June 2004 is a deferred tax benefit of RR 1,085 million in respect of the revaluation of assets transferred to FGC, Saratovskaya GES, Nizhegorodskaya GES and Novomoskavskaya GRES prior to that date (for the six months ended 30 June 2003 deferred tax benefit, resulted from transferring of property, plant and equipment into charter capital of FGC, amounted to RR 1,267 million).

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

Deferred profit tax liabilities

	30 June 2004	Movement for the period effected Statement of operations	31 December 2003
Trade receivables	(7,733)	706	(8,439)
Property, plant and equipment	65,435	143	65,292
Accounts payable	3,463	(589)	4,052
Inventories	(429)	(89)	(340)
Losses carried forward	(810)	107	(917)
Other	(1,627)	126	(1,753)
	58,299	404	57,895

(in millions of Russian Roubles)

Note 15: Profit tax (continued)

Deferred profit tax assets

	30 June 2004	Movement for the period effected Statement of operations	31 December 2003
Trade receivables	2,176	(271)	2,447
Property, plant and equipment	10,497	508	9,989
Accounts payable	(777)	95	(872)
Inventories	32	(67)	99
Losses carried forward	608	286	322
Other	989	320	669
Deferred profit tax assets	13,525	871	12,654
Less: non-recognised deferred tax assets	(9,994)	(1,221)	(8,773)
	3,531	(350)	3,881

As at 30 June 2004 the Group has not recognized a deferred tax liability in respect of RR 54,489 million (31 December 2003: RR 55,872 million) temporary differences associated with investments in subsidiaries as the Group is able to control the timing of the reversal of these temporary differences and does not intend to reverse them in the foreseeable future.

Note 16: Non-current debt

	Currency	Effective interest rate	Due	30 June 2004	31 December 2003
Central and regional government loans	US$	LIBOR + 3.0%	2004 and thereafter	2,900	2,816
Central and regional government loans	RR	21.0% - 48.0%	2004 and thereafter	475	554
Bonds issued by subsidiaries	RR	10.0% - 18.0%	2005-2007	4,500	1,000
Bonds – RAO UES	RR	15.0%	2005	3,000	3,000
Bank debt from foreign banks	Euro	EURIBOR + 4.1%	2004-2005	1,091	1,723
Bank debt from foreign banks	US$	LIBOR + 4.0%	2004-2007	1,507	1,714
Bank debt from foreign banks	US$	LIBOR + 3.5%	2004 and thereafter	897	993
Bank debt from Russian banks	RR	12.0% - 21.0%	2004 and thereafter	3,327	2,460
Bank debt from Russian banks	US$	LIBOR + 4.25%	2005	1,133	-
Other long-term debt				2,259	2,613
Total non-current debt				21,089	16,873
Less: current portion of non-current debt				(3,853)	(4,317)
				17,236	12,556

(in millions of Russian Roubles)

Note 16: Non-current debt (continued)

Maturity table

	30 June 2004	31 December 2003
Due for repayment		
Between one and two years	6,885	6,164
Between two and five years	8,544	4,353
After five years	1,807	2,039
	17,236	12,556

Except as otherwise noted, the majority of the above bank debt is obtained at fixed interest rates.

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

The Group has not entered into any hedging arrangements in respect of its foreign currency obligations or interest rate exposures.

At the balance sheet date, the estimated fair value of total non-current debt (including the current portion) was RR 22,618 million (31 December 2003: RR 17,258 million), which is estimated by discounting the future contractual cash flows at the estimated current market interest rates available to the Group for similar financial instruments.

Note 17: Other non-current liabilities

	30 June 2004	31 December 2003
Taxes payable	18,330	21,276
Trade payables	1,052	1,588
Other	7,017	6,386
Total other non-current liabilities	26,399	29,250
Less: current portion of restructured liabilities	(4,136)	(5,048)
	22,263	24,202

In accordance with Government Resolution No. 1002 dated 3 September 1999, most members of the Group have restructured taxes including fines and interest to be repaid over a period of up to 10 years. Non-adherence to certain payment schedules could result in the gross amount of taxes payable including fines and interest becoming due on demand. Additionally, a number of Group entities have restructured trade payables to be repaid over a period of up to five years. Based on the contractual dates of repayment, discount rates of 21 - 25 percent have been used in the estimate of the fair value of these liabilities at the date of restructuring.

The discounting of the restructured payable amounts gives rise to a gain, as disclosed in Note 23.

The maturity profile is as follows:

	30 June 2004	31 December 2003
Between one and two years	2,828	4,572
Between two and five years	9,374	9,457
After five years	10,061	10,173
	22,263	24,202

(in millions of Russian Roubles)

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

	Effective interest rate	30 June 2004	31 December 2003
Current debt	10.0% - 26.0%	47,461	46,179
Current portion of non-current debt		3,853	4,317
		51,314	50,496

Note 19: Accounts payable and accrued charges

	30 June 2004	31 December 2003
Trade payables	52,793	51,683
Accrued liabilities and other creditors	35,095	34,625
Bills of exchange payable	1,816	2,040
Dividends payable	4,259	466
Payables to associates	7	16
Current portion of trade payables and other creditors restructured to long-term	688	928
	94,658	89,758

For the six months ended 30 June 2004, approximately 10 percent (the six months ended 30 June 2003: 18 percent) of the Group's accounts payable and accrued charges were settled via non-cash settlements.

Restructured trade payables which are payable more than one year from the balance sheet date are reflected within other non-current liabilities as described in Note 17. The effect of restructuring the trade payables is included in Note 23.

Accrued liabilities and other creditors as at 30 June 2004 include an accrual of RR 220 million for compensation to employees whose services are to be terminated during the course of the restructuring process (31 December 2003: RR 1,079 million). The plans, including the amount of such compensation, number of employees and the approximate timing whereby such payments will be made, have been approved by the Boards of Directors of the affected Group entities.

Note 20: Taxes payable

	30 June 2004	31 December 2003
Value added tax	19,831	21,568
Fines and interest	8,147	8,429
Profit tax	1,667	4,395
Property tax	3,188	2,110
Employee taxes	2,888	2,234
Turnover taxes	159	217
Other taxes	4,296	2,570
Current portion of taxes restructured to long-term	3,448	4,120
	43,624	45,643

(in millions of Russian Roubles)

Note 20: Taxes payable (continued)

Included in the payable for value added tax is RR 16,502 which only becomes payable to the authorities when the underlying receivables balance is either recovered or written off (31 December 2003: RR 16,649 million).

The principal tax liabilities past due, excluding the amounts which have been restructured, accrue interest each day at one three hundredth of the current refinance rate of the Central Bank of the Russian Federation. As at 30 June 2004 the refinance rate was 13 percent (31 December 2003: 16 percent). Interest does not accrue on tax fines and interest.

Restructured taxes, including fines and interest, which are payable more than one year from the balance sheet date are reflected within other non-current liabilities as described in Note 17. The gain on restructuring the taxes payable is included in Note 23.

For the six months ended 30 June 2004, approximately 1 percent (the six months ended 30 June 2003: 1 percent) of the Group's taxes payable were settled via non-cash settlements.

Note 21: Governmental assistance

During the six months ended 30 June 2004 the Federal government of the Russian Federation and regional governments gave financial assistance equal to RR 1,740 million (the six months ended 30 June 2003: RR 1,560 million) for certain entities in the Far East region and RR 526 million (the six months ended 30 June 2003: RR 669 million) for other Group entities. The assistance in respect of these periods has been recorded as revenue in the statement of operations.

Note 22. Other expenses

	Six months ended 30 June 2004	**Six months ended 30 June 2003**
Rent	2,519	1,126
Consulting, legal and information services	1,790	1,015
Security services	1,414	869
Fines and interest, other than on taxes	1,403	1,539
Transportation services	1,267	664
Bank services	1,227	1,030
Charges to Energonadzor and REC	1,130	1,220
Media-Holding REN-TV expenses	1,095	758
Charity expenses	737	1,106
Connection services	607	648
Expenses related to restructuring process	587	529
Purchased heat	577	636
Business trip expenses	495	372
Labour protection costs	348	332
Other	17,404	10,628
	32,600	**22,472**

(in millions of Russian Roubles)

Note 23: Net financing expenses

	Six months ended 30 June 2004	Six months ended 30 June 2003
Gain on restructured accounts payable and taxes payable	4	1,655
Imputed interest income	-	188
Interest expense	(6,415)	(6,992)
Foreign exchange gain	714	729
	(5,697)	(4,420)

The discounting of restructured payable amounts gives rise to gain. Subsequent to its initial recognition, the discount is amortized over the period of the restructuring as an expense; RR 3,569 million of such amortisation was included in interest expense for the six months ended 30 June 2004 (the six months ended 30 June 2003: RR 3,908 million). Further information on the restructuring of accounts payable and taxes payable is contained in Notes 17, 19 and 20.

Imputed interest income is recorded as a result of the amortisation of the discount recognised in December 2001 on loans issued at that date to major suppliers of Group at below market interest rates.

Note 24: Earnings per share

	Six months ended 30 June 2004	Six months ended 30 June 2003
Weighted average number of ordinary shares outstanding (thousands)	41,041,754	41,041,754
Weighted average number of preference shares outstanding (thousands)	2,075,149	2,075,149
Adjustment for weighted average number of treasury shares (thousands)	(65,907)	(243,711)
Weighted average number of ordinary and preference shares outstanding (thousands)	43,050,996	42,873,192
Net income	15,421	16,915
Earnings per ordinary and preference share – basic and diluted (in Russian Roubles)	0.36	0.39

Note 25: Commitments

Sales commitments. The Group entered into two export contracts with Fortum Power and Heat Oy ("Fortum"), a shareholder of Lenenergo, contract with Pohjolan Voima Oy, contract with Energiameklarit Oy and contract with Kazenergoresource.

One contract with Fortum is for the supply of a minimum of 1.6 million MWh of electricity per year, at prices between Euro 12.15 and Euro 20.50 per MWh. This contract expires at the end of 2007. The second contract with Fortum is for the supply of between 0.35 million and 0.50 million MWh of electricity per year at Euro 17.25 per MWh, through to the end of 2008.

The contract with Pohjolan Voima Oy is for the supply of a minimum of 2.7 million MWh of electricity per year, at prices between Euro 17.80 and Euro 18.00 per MWh. This contract expires at the end of 2004.

Note 25: Commitments (continued)

The contract with Energiameklarit Oy specifies the supply of a maximum of 0.33 million MWh of electricity for the year 2004 at the price in Euro at Nord Pool Spot effective at the hour of delivery. The contract comes in force from 1 April 2004 and is valid till the notification of one of the parties under the contract on termination of obligations made in writing.

The contract with TOO Kazenergoresource specifies the supply of 1.44 million MWh of electricity per year. The price for electricity supplied is USD 22 per MWh. The contract shall be executed in USD or RR as agreed with the supplier. The contract expires in August 2008.

Purchase commitment. In May 2002 the Group concluded a framework agreement with its electricity supplier, Lietovus Energiya, for the period 2002-2004. The quantity of electricity to be supplied is 5.4 million MWh for the year 2004. The average price for the period 1 May 2002 to 1 May 2004 and for the period 1 May 2004 to 31 December is fixed. The Group's total purchase commitments for 2004 year amount to Euro 65 million or RR 2,294 million.

In August 2003 the Group concluded an agreement with its electricity supplier, Ekibastuzskaya GRES-2, for the period 2003-2007. The quantity of electricity to be supplied is 6.0 million MWh per annum. The price for the period August 2003 to August 2004 and for the period September 2004 to December 2005 is fixed. The average price for the period 1 January 2006 to 31 December 2007 will be defined by an additional agreement annually, but the average price will not vary by more than 10% from the latest price. The Group's total purchase commitments for the period 2003-2007 amount to RR 6,528 million.

Fuel commitments. Group entities have numerous fuel contracts. These fuel contracts represent less than the total annual fuel requirement of the Group. Additional fuel requirements are purchased through short-term agreements and on a spot basis from a variety of suppliers. Prices under the Group's natural gas and coal contracts are generally determined by reference to base amounts adjusted to reflect provisions for changes in regulatory prices, published inflation indices and current market prices.

Social commitments. Group entities contribute to the maintenance and upkeep of the local infrastructure and the welfare of its employees, including contributions toward the development and maintenance of housing, hospitals, transport services, recreation and other social needs in the geographical areas in which it operates.

Capital commitments. Future capital expenditures for which contracts have been signed amount to RR 45,983 million at 30 June 2004 and RR 43,517 million at 31 December 2003.

Note 26: Contingencies

Political environment. The operations and earnings of Group entities 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.

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

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

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

Note 26: Contingencies

As at 30 June 2004 management believes that its interpretation of the relevant legislation is appropriate and the Group's tax, currency and customs positions will be sustained. Where management believes it is probable that a position cannot be sustained, an appropriate amount has been accrued for in these financial statements.

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

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

Note 27: Financial instruments and financial risk factors

Financial risk factors. The Group's activities expose it to a variety of financial risks, including the effects of: changes in foreign currency exchange rates, changes in interest rates and the collectibility of receivables. The Group does not have a risk policy in order to hedge its financial exposures.

Credit risk. Financial assets which potentially subject Group entities 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 allowance for doubtful debtors already recorded.

Cash is placed in financial institutions, which are considered at time of deposit to have minimal risk of default.

Foreign exchange risk. The Group primarily operates within the Russian Federation, with minimal exports of electricity. The majority of the Group's purchases are denominated in Russian Roubles. The major concentration of foreign exchange risk is in relation to foreign currency denominated sales and purchase commitments (as disclosed in Note 25) and foreign currency denominated debt (as disclosed in Note 16).

Interest rate risk. The Group's income and operating cash flows are substantially independent of changes in market interest rates. The Group is exposed to interest rate risk through market value fluctuations of interest-bearing long-term borrowings. The majority of interest rates on long term borrowings are fixed, these are disclosed in Note 16. The Group has no significant interest-bearing assets.

Note 28: Subsequent events

Contingencies. In July 2004, the Constitutional Court of the Russian Federation made publicly available a recently issued interpretation of existing VAT legislation that has a possible effect of denying the recovery of input VAT or deferring the point at which the Group is able to offset input VAT to the extent the arising of such VAT is deemed to be attributable to the utilization of funds other than own funds (e.g., borrowings or funds received free of charge). In the event local taxation authorities would follow this decision and are successful in any challenge, the result, which is not practicable to determine, could have a material adverse impact on the Group's financial condition. Management is unable to predict the outcome of this uncertainty as of the date of issuing these consolidated interim financial statements.