**RAO UES GROUP**
**IFRS CONSOLIDATED FINANCIAL STATEMENTS**
**FOR THE YEAR ENDED 31 DECEMBER 2005**

PRICEWATERHOUSECOOPERS

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# AUDITORS' REPORT

**To the Shareholders and Board of Directors of the Russian Open Joint Stock Company for Energy and Electrification Unified System of Russia ("RAO UES")**

1. We have audited the accompanying consolidated balance sheet of RAO UES and its subsidiaries (the "Group") as of 31 December 2005 and the related consolidated statements of operations, of cash flows and of changes in equity for the year then ended. These consolidated financial statements as set out on pages 3 to 49 are the responsibility of the RAO UES' management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

2. We conducted our audit in accordance with International Standards on Auditing. 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.

3. In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2005, and of the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

4. Without qualifying our opinion, we draw your attention to Notes 1 and 7 to the accompanying consolidated financial statements. The Government of the Russian Federation has a controlling interest in RAO UES and Governmental economic and social policies affect the Group's financial position, results of operations and cash flows.

ZAO PricewaterhouseCoopers Audit

Moscow, Russian Federation

21 August 2006

# RAO UES Group
**Consolidated Balance Sheet as at 31 December 2005**
(in millions of Russian Roubles)

| | Notes | 31 December 2005 | 31 December 2004 |
|---|---|---|---|
| **ASSETS** | | | |
| **Non-current assets** | | | |
| Property, plant and equipment | 8 | 938,087 | 892,881 |
| Investments in associates and jointly controlled entity | 9 | 5,271 | 1,030 |
| Deferred profit tax assets | 15 | 5,444 | 5,937 |
| Other non-current assets | 10 | 42,075 | 39,439 |
| **Total non-current assets** | | **990,877** | **939,287** |
| **Current assets** | | | |
| Cash and cash equivalents | 11 | 37,125 | 35,844 |
| Accounts receivable and prepayments | 12 | 129,958 | 104,364 |
| Inventories | 13 | 44,194 | 41,956 |
| Other current assets | | 12,081 | 5,547 |
| **Total current assets** | | **223,358** | **187,711** |
| **TOTAL ASSETS** | | **1,214,235** | **1,126,998** |
| **EQUITY AND LIABILITIES** | | | |
| **Equity** | 14 | | |
| **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 | | (3,707) | (3,925) |
| Retained earnings and other reserves | | 467,797 | 462,470 |
| **Total equity attributable to the shareholders of RAO UES** | | **619,196** | **613,651** |
| Minority interest | | 237,327 | 227,633 |
| **Total equity** | | **856,523** | **841,284** |
| **Non-current liabilities** | | | |
| Deferred profit tax liabilities | 15 | 55,919 | 56,091 |
| Non-current debt | 16 | 38,792 | 20,047 |
| Other non-current liabilities | 17 | 12,807 | 17,035 |
| **Total non-current liabilities** | | **107,518** | **93,173** |
| **Current liabilities** | | | |
| Current debt and current portion of non-current debt | 18 | 88,701 | 65,949 |
| Accounts payable and accrued charges | 19 | 102,448 | 83,865 |
| Taxes payable | 20 | 59,045 | 42,727 |
| **Total current liabilities** | | **250,194** | **192,541** |
| **Total liabilities** | | **357,712** | **285,714** |
| **TOTAL EQUITY AND LIABILITIES** | | **1,214,235** | **1,126,998** |

Chairman of the Management Board — Chubais A.B.

Financial Director — Dubinin S.K.

21 August 2006

(in millions of Russian Roubles)

| | Notes | Year ended 31 December 2005 | Year ended 31 December 2004 |
|---|---|---|---|
| **Revenues** | 22 | 764,655 | 679,657 |
| **Other operating income** | 5 | 2,250 | - |
| **Operating expenses** | 23 | (695,704) | (599,563) |
| **Operating profit** | | **71,201** | **80,094** |
| Finance costs | 24 | (18,009) | (16,835) |
| Share of loss of associates and jointly controlled entity | 9 | (60) | (312) |
| **Profit before profit tax** | | **53,132** | **62,947** |
| Total profit tax charge | 15 | (29,158) | (20,097) |
| **Profit for the period** | | **23,974** | **42,850** |
| Attributable to: | | | |
| Shareholders of RAO UES | | 18,316 | 31,949 |
| Minority interest | | 5,658 | 10,901 |
| **Earnings per ordinary share for profit attributable to the shareholders of RAO UES – basic and diluted (in Russian Roubles)** | 25 | **0.42** | **0.73** |
| **Earnings per preference share for profit attributable to the shareholders of RAO UES – basic and diluted (in Russian Roubles)** | 25 | **0.59** | **0.92** |

Chairman of the Management Board — Chubais A.B.

Financial Director — Dubinin S.K.

21 August 2006

(in millions of Russian Roubles)

| | Notes | Year ended 31 December 2005 | Year ended 31 December 2004 |
|---|---|---|---|
| **CASH FLOW FROM OPERATING ACTIVITIES:** | | | |
| **Profit before profit tax** | | **53,132** | **62,947** |
| Adjustments to reconcile profit before profit tax to net cash provided by operations: | | | |
| Depreciation and impairment of property, plant and equipment | 23 | 74,128 | 69,118 |
| Doubtful debtors expense | 23 | 10,013 | 4,848 |
| Interest expenses | 24 | 17,780 | 17,609 |
| Share of loss of associates and jointly controlled entity | 9 | 60 | 312 |
| Loss on disposal of property, plant and equipment | | 2,989 | 3,528 |
| Gain on sale of subsidiary | 5 | (2,250) | - |
| Adjustment for other non-cash investing activities | | (4,456) | (8,683) |
| **Operating cash flows before working capital changes and profit tax paid** | | **151,396** | **149,679** |
| Working capital changes: | | | |
| Increase in accounts receivable and prepayments | | (36,272) | (10,218) |
| Increase in other current assets | | (3,488) | (511) |
| (Increase)/decrease in inventories | | (2,467) | 610 |
| Increase in other non-current assets | | (2,578) | (8,923) |
| Increase/(decrease) in accounts payable and accrued charges | | 21,072 | (6,509) |
| Increase/ (decrease) in taxes payable, other than profits tax | | 14,411 | (2,901) |
| Decrease in other non-current liabilities | | (18,331) | (16,004) |
| Profit tax paid | | (32,968) | (23,867) |
| **Net cash generated by operating activities** | | **90,775** | **81,356** |
| **CASH FLOW FROM INVESTING ACTIVITIES:** | | | |
| Additions to property, plant and equipment | | (102,386) | (85,323) |
| Proceeds from sale of property, plant and equipment | | 2,069 | 3,360 |
| Purchase of investments | | (2,507) | (62) |
| Proceeds from sale of subsidiary, net of cash disposed | 5 | 2,683 | - |
| Acquisition of subsidiaries, net of cash acquired | 5 | (3,100) | (1,959) |
| Acquisition of associate | 9 | (2,939) | - |
| **Net cash used for investing activities** | | **(106,180)** | **(83,984)** |
| **CASH FLOW FROM FINANCING ACTIVITIES:** | | | |
| Proceeds from issuance of current debt | | 297,445 | 230,795 |
| Proceeds from issuance of non-current debt | | 29,168 | 13,248 |
| Repayment of debt | | (290,693) | (221,357) |
| Interest paid | | (10,523) | (7,930) |
| Dividends paid to RAO UES shareholders | | (2,707) | (2,282) |
| Dividends paid by Group to minority interest shareholders | | (3,685) | (2,679) |
| Proceeds from share issuance by subsidiaries | | 416 | 258 |
| Proceeds/(cost) from sale/(purchase) of treasury shares of RAO UES, net | | 38 | (3,559) |
| Purchases of treasury shares of subsidiary, net | | (2,773) | - |
| **Net cash generated by financing activities** | | **16,686** | **6,494** |
| **Increase in cash and cash equivalents** | | **1,281** | **3,866** |
| **Cash and cash equivalents at the beginning of the period** | 11 | **35,844** | **31,978** |
| **Cash and cash equivalents at the end of the period** | 11 | **37,125** | **35,844** |

Chairman of the Management Board — Chubais A.B.

Financial Director — Dubinin S.K.

21 August 2006

## RAO UES Group
**Consolidated Statement of Changes in Equity for the year ended 31 December 2005**
(in millions of Russian Roubles)

| | Attributable to the shareholders of RAO UES | | | | | | |
|---|---|---|---|---|---|---|---|
| | Ordinary shares | Preference shares | Treasury shares | Retained earnings and other reserves | Total | Minority interest | Total equity |
| **As at 1 January 2004** | **147,439** | **7,667** | **(355)** | **432,553** | **587,304** | **219,687** | **806,991** |
| Change in fair value of available-for-sale investments | - | - | - | 277 | 277 | - | 277 |
| Translation differences | - | - | - | 82 | 82 | - | 82 |
| Net expense recognised directly in equity | - | - | - | 359 | 359 | - | 359 |
| Profit for the period | - | - | - | 31,949 | 31,949 | 10,901 | 42,850 |
| Total recognised income for the period | - | - | - | 32,308 | 32,308 | 10,901 | 43,209 |
| Change in treasury shares, net | - | - | (3,570) | 8 | (3,562) | - | (3,562) |
| Changes in Group structure | - | - | - | - | - | 920 | 920 |
| Dividends | - | - | - | (2,399) | (2,399) | (3,875) | (6,274) |
| **At 31 December 2004** | **147,439** | **7,667** | **(3,925)** | **462,470** | **613,651** | **227,633** | **841,284** |
| **As at 1 January 2005** | **147, 439** | **7,667** | **(3,925)** | **462,470** | **613,651** | **227,633** | **841,284** |
| Change in fair value of available-for-sale investments (Note 14) | - | - | - | 290 | 290 | - | 290 |
| Translation differences (Note 14) | - | - | - | (270) | (270) | - | (270) |
| Net income recognised directly in equity | - | - | - | 20 | 20 | - | 20 |
| Profit for the period | - | - | - | 18,316 | 18,316 | 5,658 | 23,974 |
| Total recognised income for the period | - | - | - | 18,336 | 18,336 | 5,658 | 23,994 |
| Change in treasury shares, net (Note 14) | - | - | 218 | (356) | (138) | - | (138) |
| Changes in Group structure (Note 14) | - | - | - | (10,166) | (10,166) | 10,166 | - |
| Acquisitions (Note 5) | - | - | - | - | - | 484 | 484 |
| Dividends (Note 14) | - | - | - | (2,758) | (2,758) | (6,614) | (9,372) |
| Employee share-option plan (Note 7) | - | - | - | 271 | 271 | - | 271 |
| **At 31 December 2005** | **147,439** | **7,667** | **(3,707)** | **467,797** | **619,196** | **237,327** | **856,523** |

Chairman of the Management Board Chubais A.B.

Financial Director Dubinin S.K.

21 August 2006

## 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, associates and jointly controlled entity. The Group principal subsidiaries as at 31 December 2005 are presented in Note 5.

The Group performs the following major activities:

- ***Generation*** – electricity and heat generation;
- ***Transmission*** – high voltage transmission of electricity;
- ***Distribution*** – delivery of electricity through distribution grids;
- ***Retailing*** – sales of electricity.

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

***Operating environment of the Group.*** Whilst there have been improvements in economic trends in the Russian Federation, the country continues to display certain 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 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.

***Relations with the state and current regulation.*** As at 31 December 2005, the Government of the Russian Federation owned 52.7 percent of RAO UES, which represents 55.0 percent of the ordinary shares issued. As discussed in Note 14, 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 (see Note 7).

The government of the Russian Federation directly affects the Group's operations through regulation by the Federal Service on Tariffs ("FST"), with respect to its wholesale energy sales, and by the regional services on tariffs ("RSTs"), with respect to its retail electricity and heat sales. 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.

As described in Notes 2, 26 and 27, 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 Electric Utilities" 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" ("Federal Law No.36-FZ"). In March 2006 changes to the Federal law No.36-FZ of 26 March 2003 were made which cancelled the moratorium on combining competitive and monopoly types of activities in the electric utility industry.

**Note 1: The Group and its operations (continued)**

- In June 2006 the Russian Federation government issued Resolution No. 355 that set the regulatory framework specifying how entities should function in the electric utility industry to satisfy their own needs as well as production needs. If followed, entities can combine competitive and monopoly types of activities in the electric utility industry.

- 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 are two sectors within the Federal Wholesale Electricity (Power) Market: regulated trading sector and free trading sector. Within the free trading sector, electricity suppliers are 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 in the European part of Russia and in the Urals. Starting from May 2005, the free trading sector was extended to Siberia, and starting from October 2005, a balancing market was put in operation. According to the laws underlying the electric utilities reform, subsequently free trading will be extended over the whole volume of trading.

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

- In October 2005 the Board of Directors of RAO UES cancelled the moratorium for disposal of core assets of the Group and determined rules on spending of proceeds from sale of property, plant and equipment and long-term investments.

- In accordance with the Concept of RAO UES Strategy, and considering the policies of the Russian Federation in respect of the process of reform of the electricity utility industry, RAO UES is developing the first stage of reorganization which assumes separation of 2-3 thermal generating companies (WGCs/TGCs) with proportional distribution of shares of the separated companies between the shareholders of RAO UES. It is planned to discuss the reorganization of RAO UES at the meeting of RAO UES shareholders during 2006. A second stage of the reorganization of RAO UES is expected to be completed in the second half of 2008.

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, no provision has been recognised for the effects of the restructuring process. Certain changes in the Group structure during the restructuring process are described in Note 5.

**Note 2: Financial condition**

As at 31 December 2005, the Group's current liabilities exceeded its current assets by Russian Roubles ("RR") 26,836 million (as at 31 December 2004 the Group's current liabilities exceeded its current assets by RR 4,830 million).

As discussed above the Group is affected by government policy through control of tariffs and other factors. The RSTs do not always permit tariff increases in line with increases in the Group's costs and thus some tariffs are insufficient to cover all the costs of generation and distribution. Moreover, these tariffs consider costs only on a Russian statutory basis and, accordingly, exclude additional costs recognised under an International Financial Reporting Standards ("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 necessary investment in generation, transmission and distribution assets.

Although management in recent years has improved significantly the absolute level of settlements for current sales the Group continues to experience problems in obtaining settlement of old accounts receivable. Currently substantially all settlements of accounts receivable are made in cash. Despite this success, there still remains a significant amount of uncollected accounts receivable from earlier periods. Management has continued its collection

**Note 2: Financial condition (continued)**

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 31 December 2005. The Group has provided against doubtful accounts receivable, as further described in Notes 10 and 12.

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 Russian electricity utility industry (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 preparation**

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

Each 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.

***Reclassifications.*** Certain reclassifications have been made to prior year data to conform to the current year presentation. These reclassifications are not material. The most significant reclassifications are the following:

- during 2005 management reassessed amount of value added tax recoverable which is expected to be reclaimed more than 12 months after the balance sheet date. Total value added tax recoverable which is expected to be reclaimed more than 12 months after the balance sheet date amounted to RR 6,432 million as at 31 December 2005. As at 31 December 2004 total value added tax recoverable, which is expected to be reclaimed more than 12 months after the balance sheet date reclassified to Other non-current assets was RR 6,878 million. Management believes that disclosure of the value added tax recoverable which is expected to be reclaimed more than 12 months after the balance sheet date within Other non-current assets in the Consolidated Balance Sheet is a fairer presentation of the Group's position;

- the format of the Consolidated statement of operations for the reporting and preceding periods was changed. Detailed presentation of revenues and operating expenses is now provided in Notes 22 and 23 respectively.

***Functional and presentation currency.*** The national currency of the Russian Federation is the RR, which is RAO UES's functional currency and the currency in which these Financial Statements are presented. All financial information presented in RR has been rounded to the nearest million.

**Note 3: Basis of preparation (continued)**

***Accounting of effect of hyperinflation***. 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 International Accounting Standards 29 ("IAS") ("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. As the characteristics of the economic environment of the Russian Federation indicated that hyperinflation ceased, effective from 1 January 2003 the Group no longer applied the provisions of IAS 29. Accordingly, the amounts expressed in the measuring unit current as at 31 December 2002 are treated as the basis for the carrying amounts in these Financial Statements.

***New accounting developments.*** During the period December 2003 to March 2006, the International Accounting Standards Board ("IASB") made 26 revisions to its standards and issued 7 new standards. In addition, the International Financial Reporting Interpretations Committee ("IFRIC") issued six new interpretations in 2004, one of which was subsequently withdrawn. These standards are effective for accounting periods commencing on or after 1 January 2005, except for IFRS 6 “Exploration and Evaluation of Mineral Resources” ("IFRS 6") and IFRS 7 "Financial instruments: disclosures" ("IFRS 7"), which are effective for periods commencing on or after 1 January 2006 and 1 January 2007 respectively, but may be adopted early.

With effect from 1 January 2005, the Group adopted all of those IFRS, which are relevant to its operations, except for IFRS 3 "Business Combinations" ("IFRS 3"), IFRS 5 "Non-current Assets Held for Sale and Discontinued Operations", IAS 36 (revised 2004) "Impairment of Assets" ("IAS 36") and IAS 38 (revised 2004) "Intangible Assets" ("IAS 38"), which were early adopted by the Group in 2004.

The adoption of IAS 1 "Presentation of Financial Statements" ("IAS 1"), IAS 2 "Inventories" ("IAS 2"), IAS 8 "Policies, Changes in Accounting Estimates and Errors" ("IAS 8"), IAS 10 "Events after the Balance Sheet Date" ("IAS 10"), IAS 16 "Property, Plant and Equipment" ("IAS 16"), IAS 17 "Leases" ("IAS 17"), IAS 21 "The Effects of Changes in Foreign Exchange Rates" ("IAS 21"), IAS 24 "Related Party Disclosures" ("IAS 24"), IAS 27 "Consolidated and Separate Financial Statements" ("IAS 27"), IAS 28 "Investments in Associates" ("IAS 28"), IAS 29 "Financial Reporting in Hyperinflationary Economies" ("IAS 29"), IAS 31 "Interests in Joint Ventures" ("IAS 31"), IAS 32 “Financial Instruments: Disclosure and Presentation" ("IAS 32"), IAS 33 "Earnings per Share" ("IAS 33"), IAS 40 "Investment Property" ("IAS 40") (all revised 2003) and IAS 39 (revised 2004) "Financial Instruments: Recognition and Measurement" ("IAS 39"), IAS 41 "Agriculture" (IAS 41), IFRS 2 "Share-based Payments" ("IFRS 2") , IFRS 4 "Insurance contracts" ("IFRS 4") and IFRS 5 “Non-current Assets Held for Sale and Discontinued Operations” (“IFRS 5”) did not result in substantial changes to the Group’s accounting policies. In summary:

The adoption of IAS 1 clarifies certain presentation requirements. Most significantly, the revised standard requires that:

- in the statement of operations, the minority interest share in the results of subsidiaries, is no longer added or subtracted in arriving at the Group’s profit or loss for the period. Instead it is presented as an allocation of the Group’s profit or loss for the period. In the balance sheet, minority interest is presented as a separate component of equity rather than being presented between equity and liabilities. As a result, the Statement of Changes in Equity shows the movement in minority interests during the period. Comparatives were restated to reflect these changes.

- the Group now classifies as current all financial liabilities for which the Group does not have an unconditional right to defer their settlements for at least twelve month after the balance sheet date. This includes loans with covenant breaches even if, after balance sheet date, and before the financial statements were issued, the lenders waived the breaches.

IAS 24 has affected the identification of related parties and some other related-party disclosures. Under IAS 24 the Group is now no longer exempt from disclosing transactions with other state-controlled entities as with parties under common Governmental control.

IAS 2, 8, 10, 16, 17, 21, 27, 28, 29, 31, 32, 33, 39, 40, 41, IFRS 2 and IFRS 4 had no material effect on the Group’s financial position, statements of operations and of cash flows.

**Note 3: Basis of preparation (continued)**

The following new Standards and Interpretations are not yet effective and have not been applied in preparing these Financial Statements:

- IFRS 7 "Financial Instruments: Disclosures", which is effective for annual periods beginning on or after 1 January 2007. The Standard will require increased disclosure in respect of the Group's financial instruments.

- Amendment to IAS 1 "Presentation of Financial Statements – Capital Disclosures", which is effective for annual periods beginning on or after 1 January 2007. The Standard will require increased disclosure in respect of the Group's capital.

- Amendment to IAS 19 "Employee Benefits", which is Amendment effective for annual periods beginning on or after 1 January 2006. The amendment to IAS 19 introduces an additional option to recognise actuarial gains and losses arising in post-employment benefit plans in full directly in retained earnings in equity. It also requires new disclosures about defined benefit plans and clarifies accounting for a contractual agreement between a multi-employer plan and participating employers.

- IFRS 6 "Exploration for and Evaluation of Mineral Resources", which is effective for annual periods beginning on or after 1 January 2006. IFRS 6 allows an entity to continue using the accounting policies for exploration and evaluation assets applied immediately before adopting the IFRS, subject to certain impairment test requirements.

- Amendment to IAS 21 "Net Investment in a Foreign Operation", which is effective for annual periods beginning on or after 1 January 2006. This amendment requires foreign exchange gains and losses on quasi-equity intercompany loans to be reported in consolidated equity even if the loans are not in the functional currency of either the lender or the borrower. Currently, such exchange differences are required to be recognised in consolidated profit or loss. It also extends the definition of 'net investment in a foreign operation' to include loans between sister companies.

- Amendment to IAS 39 "Financial Instruments: Recognition and Measurement – The Fair Value Option", which is effective for annual periods beginning on or after 1 January 2006. The amendment restricts the designation of financial instruments as "at fair value through profit or loss". The Group has not yet completed its analysis of the impact of the amendment.

- Amendment to IAS 39 "Financial Instruments: Recognition and Measurement – Cash Flow Hedge Accounting of Forecast Intragroup Transactions", which is effective for annual periods beginning on or after 1 January 2006. The amendment allows the foreign currency risk of a highly probable forecast intragroup transaction to qualify as a hedged item in the consolidated financial statements provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and the foreign currency risk will affect consolidated profit or loss.

- Amendment to IAS 39 "Financial Instruments: Recognition and Measurement – Financial Guarantee Contracts", which is effective for annual periods beginning on or after 1 January 2006. Issued financial guarantees, other than those previously asserted by the entity to be insurance contracts, will have to be initially recognised at their fair value, and subsequently measured at the higher of (i) the unamortized balance of the related fees received and deferred and (ii) the expenditure required to settle the commitment at the balance sheet date. Different requirements apply for the subsequent measurement of issued financial guarantees that prevent derecognition of financial assets or result in continuing involvement accounting.

- IFRIC 4 "Determining whether an Arrangement contains a Lease", which is effective for annual periods beginning on or after 1 January 2006. The Interpretation requires certain arrangements to be accounted for as a lease even if they are not in the legal form of a lease. The Group has not yet completed its analysis of the impact of the new Interpretation.

- IFRIC 5 "Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds", which is effective for annual periods beginning on or after 1 January 2006. Subject to certain exceptions, this interpretation prohibits offsetting a liability for decommissioning costs with an asset representing an interest in a decommissioning or similar fund and clarifies measurement of the reimbursement asset.

**Note 3: Basis of preparation (continued)**

- IFRIC 6 "Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment", which is effective for periods beginning on or after 1 December 2005, that is from 1 January 2006. The Interpretation states that a liability shared among market participants in proportion to their respective market share, in particular the liability for the decommissioning of historical waste electrical and electronic equipment in the European Union, should not be recognised because participation in the market during the measurement period is the obligating event in accordance with IAS 37.

- IFRIC 7 "Applying the Restatement Approach under IAS 29", which is effective for periods beginning on or after 1 March 2006, that is from 1 January 2007. The Interpretation clarifies application of IAS 29 in the reporting period in which hyperinflation is first identified. It states that IAS 29 should initially be applied as if the economy has always been hyperinflationary. It further clarifies calculation of deferred income taxes in the opening balance sheet restated for hyperinflation in accordance with IAS 29.

- IFRIC 8, Scope of IFRS 2, which is effective for periods beginning on or after 1 May 2006, that is from 1 January 2007. The interpretation states that IFRS 2 also applies to transactions in which the entity receives unidentifiable goods or services and that such items should be measured as the difference between the fair value of the share-based payment and the fair value of any identifiable goods or services received (or to be received).

- IFRIC 9 "Reassessment of Embedded Derivatives", which is effective for annual periods beginning on or after 1 January 2006. The Interpretation clarifies that an entity should assess whether an embedded derivative should be accounted for separately from the host contract when the entity first becomes party to the contact. Only if the contact subsequently is significantly modified the entity reassesses whether to separate or not.

- IFRIC 10 "Interim Financial Reporting and Impairment", which is effective for annual periods beginning on or after 1 November 2006. The Interpretation concludes that where an entity has recognized an impairment loss in an interim period in respect of goodwill on an investment in either an equity instrument or a financial asset carried at cost, that impairment should not be reversed in subsequent interim financial statements nor in annual financial statements.

Unless otherwise described above, the analysis in respect of these new standards and interpretations has been carried out by the Group, and they are not expected to significantly affect the Group's financial statements.

***Going concern.*** The Financial Statements have been prepared on a going concern basis, which contemplates the realisation of assets and the satisfaction of liabilities in the normal course of business. The accompanying Financial Statements do not include any adjustments should the Group be unable to continue as a going concern.

***Critical accounting estimates and assumptions.*** The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and 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 financial statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities within the next financial year include:

*Impairment provision for accounts receivable*

The impairment provision for accounts receivable is based on the Group's assessment of the collectibility of specific customer accounts. If there is deterioration in a major customer's creditworthiness or actual defaults are higher than the estimates, the actual results could differ from these estimates (see Note 10 and 12).

*Impairment of other assets and accounting for provisions*

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 the carrying value. The recoverable amount 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 statement of operations in the period in which the reduction is identified. If conditions change and management determines that the asset value has increased, the impairment provision will be fully or partially reversed.

**Note 3: Basis of preparation (continued)**

Accounting for impairment includes provisions against property, plant and equipment, investments, other non-current assets and inventory obsolescence. The provisions for liabilities and charges primarily include provisions for environmental and pension liabilities, legal proceedings. The Group records impairment or accrues these provisions when its assessments indicate that it is probable that a liability has been incurred or an asset will not be recovered, and an amount can be reasonably estimated. The Group's estimates for provisions for liabilities and charges are based on currently available facts and the Group's estimates of the ultimate outcome or resolution of the liability in the future.

Actual results may differ from the estimates, and the Group's estimates can be revised in the future, either negatively or positively, depending upon the outcome or expectations based on the facts surrounding each exposure. Provisions for pension obligations are periodically adjusted based on updated actuarial assumptions (see Note 21).

*Fair value of acquired assets and liabilities*

The Group has recently completed acquisitions (see Note 5 and Note 9). IFRS 3 required that, at the date of acquisitions, all identifiable assets, liabilities and contingent liabilities of an acquired entity to be recorded at their respective fair values. The estimation of fair values requires management judgment. Changes in any of the estimates subsequent to the finalization of acquisition accounting may result in losses or profits in future periods.

*Tax contingencies*

Russian tax legislation is subject to varying interpretations and changes, which can occur frequently. Where the Group management believes it is probable that their interpretation of the relevant legislation and the Group's tax positions cannot be sustained, an appropriate amount is accrued for in the IFRS financial information (see Note 27).

*Useful lives of property, plant and equipment*

The estimation of the useful lives of an item of property, plant and equipment is a matter of management judgment 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.

*Deferred tax*

As at 31 December 2005 and 31 December 2004 the Group has not recognized a deferred tax liability in respect of temporary differences associated with investments in all its subsidiaries that may crystallize depending on how the RAO UES restructuring is effected in the future (see Note 15).

**Note 4: Summary of significant accounting policies**

***Principles of consolidation.*** The 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. In these circumstances, control exists on the basis of a significant shareholding combined with other factors which allow the Group to exercise control, namely: RAO UES has the majority in the Board of Directors, RAO UES is the dominant owner, or RAO UES has major influence over the company operations through its ownership and operation of the Unified Energy System.

The majority of the principal subsidiary companies described in Note 5 were transferred to the Group by the state on and after the incorporation of RAO UES as a joint stock company, or as a result of the Group restructuring. These transfers represent a reorganisation of assets under common control and, accordingly, were accounted for in a manner similar to the uniting of interests method of accounting from the date of privatisation of each Group entity, or from the date of Group restructuring.

All inter-company balances and transactions have been eliminated. The minority interest has been disclosed as part of equity.

**Note 4: Summary of significant accounting policies (continued)**

***Investments in associates and jointly controlled entity.*** Investments in associated enterprises and jointly controlled entities 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 exercises significant influence but which it does not control.

When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

A jointly controlled entity is a joint venture that involves the establishment of a corporation, partnership or other entity in which each venturer has an interest. The entity operates in the same way as other entities, except that a contractual arrangement between the venturers establishes joint control over the economic activity of the entity.

The Group discontinues the use of the equity method from the date on which it ceases to have joint control over, or have significant influence in, associates and a jointly controlled entity.

Unrealised gains arising from transactions with associates and jointly controlled entities are eliminated to the extent of the Group's interest in the entity.

***Business combinations.*** All business combinations are accounted for by applying purchase method of accounting. Where the Group obtains control of an entity or a business, it measures the cost of the business combination as the aggregate of:

(a) the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the Group, in exchange for control of the acquiree; and

(b) any costs directly attributable to the business combination.

The acquisition date is the date when the Group effectively obtains control of the acquiree.

***Goodwill.*** Goodwill is recognised on acquisitions of subsidiaries, associates and jointly controlled entities. Goodwill arising on the acquisitions represents any excess of the purchase consideration over the acquirer's interest in the net fair value of identifiable assets, liabilities and contingent liabilities. Goodwill is recognised at cost less impairment losses. The carrying amount of goodwill is assessed for impairment on an annual basis. In respect of associates and a jointly controlled entity, the carrying amount of goodwill is included in the carrying amount of the investment.

Any excess of the fair value of the net identifiable assets acquired over the cost of acquisition is recognised immediately in the statement of operations.

***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 categorisation, current or non-current, at the time of the purchase and re-evaluates it based on maturity at each reporting date.

Available-for-sale investments principally comprise non-marketable securities, which are not publicly traded or listed on 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.

Purchases and sales of investments are initially measured at fair value and 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.

(in millions of Russian Roubles)

**Note 4: Summary of significant accounting policies (continued)**

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 RR 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 RR at the exchange rate prevailing at the reporting date. statements of operations of foreign entities are translated at the 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 the translation reserve in equity.

As at 31 December 2005, the official rate of exchange, as determined by the Central Bank of the Russian Federation, between the RR and the US Dollar ("USD") was RR 28.78: USD 1.00 (31 December 2004: RR 27.75: USD 1.00), between the RR and EURO RR 34.19: EURO 1.00 (31 December 2004: RR 37.81: EURO 1.00).

***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 declared after the balance sheet date, but before the financial statements are authorized for issue.

***Property, plant and equipment.*** Property, plant and equipment is stated at depreciated cost less impairment. Deemed cost was initially determined by a third party valuation as at 31 December 1997 and restated for the impact of inflation until 31 December 2002. Adjustments are made for additions, disposals and depreciation charges. 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 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, in accordance with paragraph 16 of IAS 29. 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 and the Group has not adopted a policy of revaluation on subsequent measurement. The change in carrying value arising from this valuation was recorded directly to retained earnings.

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

Depreciation on property, plant and equipment is calculated on a straight-line basis over the estimated useful life of the asset when it is available for use. For the property, plant and equipment which were 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 – 50 | 20 – 50 |
| Electricity transmission | 14 – 19 | 25 |
| Electricity distribution | 3 – 40 | 25 |
| Heating network | 3 – 43 | 20 |
| Other | 8 – 24 | 10 |

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

**Note 4: Summary of significant accounting policies (continued)**

***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 ("VAT") 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 (deferred VAT) is recognised in the balance sheet on a gross basis and disclosed separately as an asset and liability. Where provision has been made for impairment of receivables, the impairment loss is recorded for the gross amount of the debtor's balance, including VAT. The related deferred VAT liability is maintained until the debtor is written off for tax purposes.

***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 selling expenses.

***Deferred profit taxes.*** Deferred profit 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 and liabilities are netted only within the individual companies of the Group. 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 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. If accounts payable are restructured and the discounted present value of the cash flows under the restructured terms discounted using the original effective interest rate differs by more than ten percent from the discounted present value of the remaining cash flows of the original financial liability, then the fair value of the restructured payable is measured as the discounted present value of the cash flows under the restructured terms. In this case the amount of the discount is credited to the statement of operations (finance costs - net) 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.

***Debt.*** Debt is recognised initially at its fair value. 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. Prior to 2005, certain interest costs on borrowings used to finance the construction of property, plant and equipment were capitalized during the period of construction of those assets; all other borrowing costs were expensed. During 2005 the Group changed its accounting policy to the benchmark treatment prescribed by IAS 23 "Borrowing Costs" of recognizing all borrowing costs as an expense in the period in which they are incurred. Management believes that the new policy is preferable because it results in a more transparent treatment of finance costs.

**Note 4: Summary of significant accounting policies (continued)**

No adjustments were required to the financial statements or to any periods prior to those presented in order to implement the new policy.

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

In prior periods, the Group followed a 'parent company' approach to transactions with minorities: any gains and losses resulting from sales of shares to minority shareholders were recorded in the statements of operations. In 2005 the Group changed its accounting policy to adopt an 'economic entity' approach, whereby minorities are treated as equity participants. As a consequence, all the gains and losses resulting from the purchases and sales of the minority interest are recognised in the statements of changes in equity. Management believes that the new policy results in a clearer and more consistent presentation of the transactions between equity participants, in particular those arising in connection with restructuring and respective changes in the Group structure. No material adjustments were required to any prior periods presented to implement the policy.

***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 and included in employee benefit expenses and payroll taxes in the statements of operations.

A number of Group entities operate defined benefit plans that cover the majority of the Group's employees. Benefit plans define 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 the defined benefit pension plans is the present value of the defined benefit obligation at the balance sheet date less the fair value of plan assets, together with adjustments for unrecognised actuarial gains or losses. The defined benefit obligations are calculated using the projected unit credit method. The present value of the defined benefit obligations are determined by discounting the estimated future cash outflows using interest rates of government bonds that are denominated in the currency in which the benefits will be paid associated with the operation of the plans, and that have terms to maturity approximating the terms of the related pension liabilities.

Actuarial gains and losses arising from changes in actuarial assumptions and exceeding 10% of the defined benefit obligations are charged or credited to the statement of operations over the average remaining service lives of employees starting from the next reporting period.

***Non-current assets classified as held for sale.*** Non-current assets and disposal groups (which may include both non-current and current assets) are classified in the balance sheet as 'Non-current assets held for sale' if their carrying amount will be recovered principally through a sale transaction within twelve months after the balance sheet date. Assets are reclassified when all of the following conditions are met at the balance sheet date: (a) the assets are available for immediate sale in their present condition; (b) the Group's management approved and initiated an active programme to locate a buyer; (c) the assets are actively marketed for a sale at a reasonable price; (d) the sale is expected to occur within one year and (d) it is unlikely that significant changes to the plan to sell will be made or that the plan will be withdrawn.

***Finance leases.*** Where the Group is a lessee in a lease which transferred substantially all the risks and rewards incidental to ownership to the Group, the assets leased are capitalised in property, plant and equipment at the commencement of the lease at the lower of the fair value of the leased asset and the present value of the minimum lease payments. The corresponding rental obligations, net of future finance charges, are included in debts. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding. The interest cost is charged to the statement of operations over the lease period using the effective interest method. The assets acquired under finance leases are depreciated over their useful life or the shorter lease term if the Group is not reasonably certain that it will obtain ownership by the end of the lease term.

***Share-based payment transactions.*** The share option programme allows Group employees to acquire shares of the RAO UES. The fair value of the options is measured at grant date and spread over the period during which the employees become unconditionally entitled to the options. The fair value of the options is measured based on the Black-Scholes formula, taking into account the terms and conditions upon which the instruments were granted.

**Note 4: Summary of significant accounting policies (continued)**

***Embedded derivative.*** The Group enters into purchase agreement for fuel within ordinary course of business. The contracts were entered into and continue to be held for the purpose of receipt or delivery of commodities in accordance with the Group's expected usage requirements and they are not within the scope of IAS 39 but need to be assessed at inception to determine if they contain embedded derivatives.

An embedded derivative is one or more implicit or explicit terms in a contract affect the cash flows of the contract in a manner similar to a stand-alone derivative instrument. Any embedded derivative that meets the separation criterion is separated from its host contracts and measured as if it were a stand-alone derivative if its economic characteristics are not closely related to those of the host contract.

***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 during the period. Revenue amounts are presented exclusive of value added tax.

***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. The earnings per share is determined by dividing the profit 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 equity attributable to the shareholders of RAO UES.

***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.

**Note 5: Principal subsidiaries**

All subsidiaries with exception of foreign companies are incorporated and operate in the Russian Federation. As described in Note 6, in the frame of restructuring the Group is organized into six main business segments. The principal subsidiaries are presented below according to their allocation to the business segments as at 31 December 2005.

***Energo companies***

Prior to 2005 RAO UES had ownership interests in more than 70 regional vertically integrated power companies ("Energo") responsible for the generation, distribution and sales of heat and electricity. These ownership interests range from 47 percent to 100 percent. During the sector restructuring the Energo companies are being mainly split into generation, distribution, transmission and retailing companies.

Currently all the Energo companies that are subject to the restructuring process have developed their plans for reorganization and submitted them to RAO UES. The Board of Directors of RAO UES approved plans for reorganization of 68 Energo companies.

As at 1 July 2006 54 Energo companies of RAO UES Group had held general meeting of shareholders at which plans for reorganisation have been approved and the state registration was completed for newly created companies which were split from 57 Energo companies.

As at 31 December 2005 the significant Energo companies were:

(in millions of Russian Roubles)

**Note 5: Principal subsidiaries (continued)**

| Name | Ownership % | Voting % | Name | Ownership % | Voting % |
|---|---|---|---|---|---|
| ***East*** | | | | | |
| Dalenergo | 49.0 | 65.3 | Khabarovskenergo | 48.5 | 60.2 |
| Kolymaenergo | 83.7 | 83.7 | Yakutskenergo | 47.9 | 56.3 |
| ***South*** | | | ***Siberia*** | | |
| Kubanenergo | 49.0 | 49.0 | Altayenergo | 54.7 | 72.2 |
| Sulakenergo | 99.2 | 99.2 | Kuzbassenergo | 49.0 | 49.0 |

### *Generating companies*

The wholesale generating companies (WGCs) have been established as subsidiaries of RAO UES with payment for their authorized capitals in shares of subsidiaries of RAO UES and RAO UES-owned property of power plants. Further, WGCs will comprise power plants (generating companies) separated from the Energo companies in the process of their restructuring. It is planned that the power plants will merge with and into the corresponding WGCs, which became their parent companies.

A detailed description of the major changes that are planned to take place to the wholesale generating companies (WGCs) and the territorial generating companies (TGCs) during the restructuring process is set out in the Appendixes to the Concept of RAO UES Strategy "Generating companies of the Wholesale Electricity Market" and "Territorial generating companies being created on the basis of assets of Holding Company RAO UES" approved by the Board of Directors of RAO UES in February 2006.

As at 31 December 2005 the significant generating companies were:

| Name | Ownership % | Voting % | Name | Ownership % | Voting % |
|---|---|---|---|---|---|
| ***Centre*** | | | ***North-West*** | | |
| Mosenergo | 50.9 | 50.9 | Kaliningradskaya TETS | 88.5 | 88.5 |
| Ryazanskaya GRES | 100.0 | 100.0 | North-West Station | 83.2 | 94.5 |
| Federal hydro generating company | 100.0 | 100.0 | Peterburgskaya generating company | 56.0 | 67.1 |
| Wholesale Generating company-3 | 63.8 | 63.8 | Territorial generating company-1 | 59.6 | 100.0 |
| ***Middle Volga*** | | | ***Siberia*** | | |
| Saratovenergo | 49.0 | 64.0 | Berezovskaya GRES-1 | 100.0 | 100.0 |
| Volzhskaya territorial generating company | 49.3 | 100.0 | Boguchanskaya GES | 64.2 | 64.2 |
| Territorial generating company-9 | 50.0 | 50.0 | Krasnoyarskaya generaciya | 52.2 | 66.8 |
| ***Ural*** | | | ***South*** | | |
| Tyumenskaya regional generating company | 100.0 | 100.0 | Novocherkasskaya GRES | 100.0 | 100.0 |
| Wholesale generating company-1 | 100.0 | 100.0 | Stavropolskaya GRES | 51.1 | 51.1 |
| Wholesale generating company-4 | 100.0 | 100.0 | Wholesale generating company-2 | 100.0 | 100.0 |
| Wholesale generating company-5 | 90.3 | 90.3 | Wholesale generating company-6 | 100.0 | 100.0 |
| Permskaya generating company | 49.0 | 64.4 | | | |
| ***East*** | | | | | |
| Bureyskaya GES | 94.7 | 94.9 | | | |
| Zeyskaya GES | 56.9 | 72.5 | | | |

### *Transmission companies*

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.

(in millions of Russian Roubles)

**Note 5: Principal subsidiaries (continued)**

OAO System Operator-Central Dispatch Unit of Unified Energy System ("SO-CDU") was established in September 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.

As at 31 December 2005 the significant transmission grid companies were:

| Name | Ownership % | Voting % | Name | Ownership % | Voting % |
|---|---|---|---|---|---|
| Federal grid company | 100.0 | 100.0 | System operator CDU UES | 100.0 | 100.0 |
| Magistralnaya grid company | 50.9 | 50.9 | Tomskie transmission grids | 52.0 | 59.9 |

***Distribution companies***

As at 31 December 2005 4 Interregional Distribution Grid Companies (“IDGCs”) had been established. It is planned that shares of the distribution companies separated from the Energo companies as a result of the restructuring process will be exchanged for shares of IDGCs.

As at 31 December 2005 the significant distribution companies were:

| Name | Ownership % | Voting % | Name | Ownership % | Voting % |
|---|---|---|---|---|---|
| ***Centre*** | | | ***North-West*** | | |
| Vologdaenergo | 49.0 | 49.0 | Kolenergo | 49.3 | 65.5 |
| Moskovskaya city power grid company | 50.9 | 50.9 | Lenenergo | 56.0 | 63.6 |
| Moskovskaya oblastnaya power grid company | 50.9 | 50.9 | Komienergo | 50.1 | 50.3 |
| ***Ural*** | | | ***South*** | | |
| Permenergo | 49.0 | 49.0 | Rostovenergo | 48.4 | 62.8 |
| Sverdlovenergo | 49.0 | 65.3 | Stavropolenergo | 55.1 | 71.9 |
| Tyumenenergo | 100.0 | 100.0 | | | |
| ***Middle Volga*** | | | ***Siberia*** | | |
| Samaraenergo | 49.5 | 56.9 | Krasnoyarskenergo | 52.2 | 66.7 |
| Ulyanovskenergo | 49.0 | 49.0 | | | |
| Volzhskaya interregional distribution company | 49.2 | 100.0 | | | |

***Retailing companies***

As at 31 December 2005 the significant retailing companies were:

| Name | Ownership % | Voting % | Name | Ownership % | Voting % |
|---|---|---|---|---|---|
| ***Centre*** | | | ***Ural*** | | |
| Volgogradenergosbyt | 49.3 | 61.6 | Permskaya energy retail company | 49.0 | 64.4 |
| Mosenergosbyt | 50.9 | 50.9 | Sverdlovenergosbyt | 49.0 | 65.3 |
| Nizhegorodskaya retail company | 49.0 | 62.3 | Chelyabenergosbyt | 49.0 | 58.1 |
| Belgorodskaya retail company | 49.0 | 65.3 | Tyumenskaya energy retail company | 100.0 | 100.0 |
| ***Middle Volga*** | | | ***South*** | | |
| Chuvashskaya energy retail company | 100.0 | 100.0 | Energy retail company Rostovenergo | 48.4 | 62.8 |
| ***North-West*** | | | | | |
| Karelskaya energy retail company | 100.0 | 100.0 | | | |
| Peterburgskaya retail company | 56.0 | 67.1 | | | |

(in millions of Russian Roubles)

## Note 5: Principal subsidiaries (continued)

***Unallocated***

***Foreign companies***

| Name | Ownership % | Voting % | Country |
|---|---|---|---|
| RAO Nordic Oy | 60.0 | 100.0 | Finland |
| Interenergo B. V. | 40.2 | 67.0 | Netherlands |
| MEK | 54.0 | 100.0 | Armenia |
| Silk Road Holdings B.V. | 60.0 | 100.0 | Netherlands |
| Gardabani Holdings B.V. | 60.0 | 100.0 | Netherlands |
| ES Georgia Holdings B.V. | 60.0 | 100.0 | Netherlands |
| Telasi | 45.0 | 75.0 | Georgia |
| Mtkvari | 60.0 | 100.0 | Georgia |

***Others***

| Name | Ownership % | Voting % |
|---|---|---|
| OAO COR UES | 100.0 | 100.0 |
| Energy Centre | 75.0 | 75.0 |
| Engineering Centre UES | 100.0 | 100.0 |
| Inter RAO UES | 60.0 | 60.0 |

The Group also 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. Typically RAO UES does not hold any preference shares of its subsidiaries. Unless dividends have not been declared fully at the Annual shareholders' meeting such preference shares do not have any voting rights.

In the course of 2005 the Group made several acquisitions. Details of significant acquisitions are presented below.

***Acquisition of Moldavskaya GRES and Saint Guidon Invest N.V.***

In March 2005, RAO Nordic Oy, the Group entity, acquired 51.0 percent of the shares of ZAO Moldavskaya GRES (Republic of Moldova, Pridnestrovski region). The total consideration paid in cash was RR 1,400 million (USD 50 million). However, control over the entity was not obtained as at that date as the company's Charter documentation required a 75% vote for any resolution to be passed.

In August 2005 RAO Nordic Oy acquired 100.0 percent of the shares of Saint Guidon Invest N.V. (Belgium), the holder of 49 percent of the shares of ZAO Moldavskaya GRES and the provider of a loan to ZAO Moldavskaya GRES in the amount of RR 639 million (USD 22 million), including interest, as at the date of acquisition. The total consideration paid in cash was RR 980 million (USD 35 million). This acquisition allowed the Group to make an amendment to the Charter documentation of ZAO Moldavskaya GRES such that only more than 50 percent of the votes were required to pass a resolution, and control over ZAO Moldavskaya GRES was, consequently, obtained.

In November 2005 RAO Nordic Oy and Saint Guidon Invest N.V. sold 37.0 percent and 12.0 percent of the shares of ZAO Moldavskaya GRES for RR 998 million (USD 36 million) and RR 89 million (USD 3 million) respectively. The Group's interest in ZAO Moldavskaya was, consequently, reduced to 51 percent.

ZAO Moldavskaya GRES contributed revenue of RR 593 million and a net loss of RR 82 million to the Group for the period from the date of acquisition to 31 December 2005. If the acquisition had occurred as at 1 January 2005, the Group revenue would have increased by RR 2,131 million, and an additional loss before allocation would have been recognised of RR 697 million.

No valuation of the assets and liabilities of ZAO Moldavskaya GRES was performed prior to the acquisition. The management anticipates this valuation will be finalised within the first year period after obtaining the control over ZAO Moldavskaya GRES. Consequently, the results of this valuation will be taken into account in the Group's Financial Statement in future periods.

(in millions of Russian Roubles)

**Note 5: Principal subsidiaries (continued)**

The provisional fair value of assets and liabilities arising from the acquisition are as follows:

| | |
|---|---|
| Property, plant and equipment | 1,988 |
| Other non-current assets | 10 |
| Accounts receivable and prepayments | 205 |
| Inventories | 392 |
| Cash and cash equivalents | 52 |
| Non-current debt | (285) |
| Current debt and current portion of non-current debt | (87) |
| Total accounts payable and accrued charges | (759) |
| **Fair value of net assets acquired** | **1,516** |
| Less: Minority interest | (484) |
| **Fair value of acquired interest in net assets of entity** | **1,032** |
| Goodwill | 220 |
| **Total purchase consideration** | **1,252** |
| Less: cash and cash equivalents in entity acquired | (52) |
| **Cash outflow on the acquisition** | **1,200** |

The provisional fair value of assets and liabilities at the date of the acquisition reflects the carrying values.

Goodwill arising on the acquisition is expected to be supported by the expected synergies from the acquired business and is included within Other non-current assets (see Note 10).

*Acquisition of ZAO Elektricheskie Seti Armenii*

In June 2005, Interenergo B.V., a 40.0 percent owned Group subsidiary, obtained control over 100.0 percent of the shares of ZAO Electricheskie Seti Armenii (Republic of Armenia). The total consideration paid in cash was RR 2,089 million (USD 73 million).

The acquired subsidiary contributed revenue of RR 2,185 million and a net loss of RR 31 million to the Group for the period from the date of acquisition to 31 December 2005. If the acquisition had occurred as at 1 January 2005, Group revenue would have increased by RR 4,494 million and an additional net loss would have been recognised of RR 150 million. The fair and carrying values of assets and liabilities arising from the acquisition are as follows:

| | Fair value | Carrying value |
|---|---|---|
| Property, plant and equipment | 2,356 | 4,219 |
| Accounts receivable and prepayments | 576 | 716 |
| Inventories | 90 | 90 |
| Cash and cash equivalents | 3 | 3 |
| Current debt | (249) | (249) |
| Deferred tax liabilities | (138) | (557) |
| Accounts payable and accrued charges | (549) | (595) |
| **Fair value of net assets acquired** | **2,089** | **3,627** |
| **Total purchase consideration** | **2,089** | **-** |
| Less: cash and cash equivalents in entity acquired | (3) | - |
| **Cash outflow on the acquisition** | **2,086** | **-** |

(in millions of Russian Roubles)

**Note 5: Principal subsidiaries (continued)**

Minority interest was not recognised in relation to ZAO Electricheskie Seti Armenii due to the negative net assets position of Interenergo B.V. consolidated with the entity acquired.

***Sale of Media-Holding REN TV***

On 1 July 2005 the Board of Directors of RAO UES approved the divestiture by Centre of settlement optimization UES of its stake in Media-Holding REN TV. The decision to divest was driven by the sector restructuring and the resolutions of the Board of Directors of RAO UES of 6 March 2002 and 28 February 2003 that it was necessary for the Group to dispose of their non-core assets. In July 2005, the Group sold its 70.0 percent shareholding in Media-Holding REN TV, an entity which holds television broadcasting equipment and licenses. The gain on the sale of REN TV amounted to RR 2,250 million and was included in the other operating income for the year ended 31 December 2005. The total consideration received in cash was RR 2,872 million (USD 100 million). Prior to its disposal REN TV was included in the "Unallocated" segment.

The carrying value of assets and liabilities arising from the disposal are as follows:

| | |
|---|---|
| Property, plant and equipment | 230 |
| Other non-current assets | 283 |
| Trade and other receivables | 630 |
| Other current assets | 12 |
| Inventories | 241 |
| Cash and cash equivalents | 188 |
| Non-current debt | (5) |
| Other non-current liabilities | (8) |
| Deferred tax liabilities | (22) |
| Total accounts payable and accrued charges | (660) |
| **Net identifiable assets and liabilities** | **889** |
| Less: Minority interest | (267) |
| **Net assets of entity** | **622** |
| Gain on sale | 2,250 |
| **Total consideration received** | **2,872** |
| Cash disposed of | (189) |
| **Net cash inflow on the disposal** | **2,683** |

**Note 6: Segment information**

As described in Note 1 and 5 the Group underwent significant restructuring, which affected identification of its primary reporting segments. It is not practicable to restate the comparative segment information for the previous period due to the nature of the accounting records maintained by the Group in relation to the newly established companies that formed subdivisions of Energo companies prior to restructuring. The primary reporting segments for the current period are presented on the previous and the new basis of the segment identification.

A significant portion of the restructuring occurred on 1 April 2005. As there is no management report available on the new basis for the period before the restructuring, the income and expenses for that period were allocated on actual basis with the exception of the wages, repair and maintenance, taxes other than income tax and other expenses. These expenses were extrapolated based on the actual expenses for the period from restructuring to the end of the current period in the view that the operations remain similar in size and nature throughout the current period.

**Note 6: Segment information (continued)**

***Primary reporting segments on the previous basis.*** The Group was organised into four main business segments:

- ***"Hydro and thermal generating stations segment"*** consisted of entities that produced and sold electricity to Energos through FOREM, at tariffs set by the FST;
- ***"Transmission segment"*** this segment principally comprised RAO UES, FGC and SO-CDU, which maintained and operated the high voltage electricity transmission grid and performed electricity dispatch functions. Transmission fees are set by the FST;
- ***"Energos segment"*** consisted of regional electricity and heat generation and distribution. The majority of electricity generated by Energos was sold within the regions in which the Energo operates at tariffs set by RSTs. Certain Energos had surplus generation and sold electricity via FOREM. Tariffs in FOREM are set by FST;
- ***"Unallocated"*** consisted of numerous insignificant segments including construction, export generation and sales.

***Primary reporting segments on the new basis.*** In the frame of restructuring, the Group is organised into six main business segments:

- ***"Generation segment"*** consists of companies responsible for electricity and heat generation. Heat is sold within the regions in which the companies operate at tariffs set by RSTs. Electricity is sold within the regions and through FOREM based on tariffs set by RSTs and FST. The majority of electricity sales are within the Group. In prior periods the segment information was included into the "Energos segment" and "Hydro and thermal generating stations segment";
- ***"Transmission segment"*** this segment principally comprises RAO UES, FGC and SO-CDU, which maintain and operate the high voltage electricity transmission grid and perform electricity dispatch functions. Transmission fees are set by the FST;
- ***"Distribution segment"*** consists of companies, which are responsible for the delivery of electricity through the low voltage distribution grids at tariffs set by RSTs. The majority of the distribution fees is charged by the distribution segment to the retail segment. In prior periods the segment information was included into the "Energos segment";
- ***"Retailing segment"*** consists of companies, which are responsible for sale of electricity to the customers at tariffs set by RSTs. In prior periods the segment information was included into the "Energos segment". The cost of sales of the retailing segment includes power purchased from the generation segment, the transmission fees charged by the transmission segment (where applicable) and the distribution fees charged by the distribution segment;
- ***"Energos segment"*** consists of companies, which have not begun or are in the process of restructuring and responsible for the generation, distribution and sale of heat and electricity. In future periods, in the process of restructuring, the size of this segment will be reduced in favour of other segments. Energos which have completed their restructuring process and performed only one type of activity during the year ended 31 December 2005, have been included in the respective segments;
- ***"Unallocated"*** consists of numerous insignificant segments including construction, repair, export sales and foreign companies of the Group.

(in millions of Russian Roubles)

### Note 6: Segment information (continued)

### New basis

### Year ended 31 December 2005

| | Generation | Transmission | Distribution | Retailing | Energos | Unallocated | Consolidation adjustments | Total |
|---|---|---|---|---|---|---|---|---|
| Third parties | 126,572 | 9,560 | 15,886 | 405,046 | 175,133 | 34,708 | - | **766,905** |
| Inter-segment | 295,293 | 56,906 | 107,534 | 34,988 | 2,271 | 6,861 | (503,853) | - |
| **Total revenues** | **421,865** | **66,466** | **123,420** | **440,034** | **177,404** | **41,569** | **(503,853)** | 766,905 |
| **Segment operating profit/ (loss)** | **20,770** | **27,463** | **9,992** | **(3,965)** | **5,123** | **11,818** | **-** | **71,201** |
| Finance costs | - | - | - | - | - | - | - | **(18,009)** |
| Share of loss of associates and jointly controlled entity | - | - | - | - | - | - | - | **(60)** |
| Profit before profit tax | - | - | - | - | - | - | - | **53,132** |
| Total profit tax charge | - | - | - | - | - | - | - | **(29,158)** |
| **Profit for the period** | - | - | - | - | - | - | - | **23,974** |
| Capital expenditures | 45,093 | 22,365 | 32,616 | 1,059 | 21,327 | 4,946 | - | **127,406** |
| Depreciation of property, plant and equipment | 29,350 | 12,632 | 15,781 | 418 | 11,298 | 190 | - | **69,669** |
| Impairment of property, plant and equipment | - | - | - | - | 3,316 | 1,143 | - | **4,459** |
| Doubtful debtors expense / (reversal) | 2,816 | (205) | (1,588) | 3,777 | 4,976 | 237 | - | **10,013** |

(in millions of Russian Roubles)

## Note 6: Segment information (continued)

***Previous basis***

### Year ended 31 December 2005

| | Hydro and thermal generating stations | Transmission | Energos | Unallocated | Consolidation adjustments | Total |
|---|---|---|---|---|---|---|
| Third parties | 21,142 | 8,263 | 706,332 | 31,168 | - | **766,905** |
| Inter-segment | 70,320 | 56,425 | 12,890 | 1,812 | (141,447) | - |
| **Total revenues** | **91,462** | **64,688** | **719,222** | **32,980** | **(141,447)** | 766,905 |
| **Segment operating profit/(loss)** | **6,047** | **29,648** | **23,264** | **12,242** | **-** | **71,201** |
| Finance costs | - | - | - | - | - | **(18,009)** |
| Share of loss of associates and jointly controlled entity | - | - | - | - | - | **(60)** |
| Profit before profit tax | - | - | - | - | - | **53,132** |
| Total profit tax charge | - | - | - | - | - | **(29,158)** |
| **Profit for the period** | - | - | - | - | - | **23,974** |
| Capital expenditures | 33,218 | 22,087 | 68,398 | 3,703 | - | **127,406** |
| Depreciation of property, plant and equipment | 9,573 | 9,776 | 50,040 | 280 | - | **69,669** |
| Impairment of property, plant and equipment | - | - | 3,316 | 1,143 | - | **4,459** |
| Doubtful debtors expense / (reversal) | 428 | (211) | 9,596 | 200 | - | **10,013** |

(in millions of Russian Roubles)

### Note 6: Segment information (continued)

### Year ended 31 December 2004

| | Hydro and thermal generating stations | Transmission | Energos | Unallocated | Consolidation adjustments | Total |
|---|---|---|---|---|---|---|
| Third parties | 25,764 | 5,184 | 627,089 | 21,620 | - | **679,657** |
| Inter-segment | 50,339 | 50,889 | 17,792 | 15,149 | (134,169) | **-** |
| **Total revenues** | **76,103** | **56,073** | **644,881** | **36,769** | **(134,169)** | 679,657 |
| **Segment operating profit/(loss)** | **7,555** | **29,510** | **42,608** | **421** | **-** | **80,094** |
| Finance costs – net | - | - | - | - | - | **(16,835)** |
| Share of loss of associates and jointly controlled entity | - | - | - | - | - | **(312)** |
| Profit before profit tax | - | - | - | - | - | **62,947** |
| Total profit tax charge | - | - | - | - | - | **(20,097)** |
| **Profit for the period** | - | - | - | - | - | 42,850 |
| Capital expenditures | 22,548 | 18,032 | 57,225 | 1,607 | - | **99,412** |
| Depreciation of property, plant and equipment | 7,968 | 9,786 | 46,920 | 757 | - | **65,431** |
| Impairment of property, plant and equipment | - | - | - | 3,687 | - | **3,687** |
| Doubtful debtors (reversal)/ expense | 101 | (784) | 4,861 | 670 | - | **4,848** |

(in millions of Russian Roubles)

## Note 6: Segment information (continued)

*New basis*

**As at 31 December 2005**

| | Generation | Transmission | Distribution | Retailing | Energos | Unallocated companies | Total |
|---|---|---|---|---|---|---|---|
| Segment assets | 489,816 | 202,904 | 242,584 | 37,563 | 214,191 | 357,106 | **1,544,164** |
| Inter-segment balances | (15,907) | (1,885) | (15,326) | (733) | (9,998) | (305,079) | **(348,928)** |
| **Total segment assets** | **473,909** | **201,019** | **227,258** | **36,830** | **204,193** | **52,027** | **1,195,236** |
| Investments in associates | - | - | - | - | 1,061 | 4,210 | **5,271** |
| Current and deferred tax assets | - | - | - | - | - | - | **13,278** |
| **Total assets** | **-** | **-** | **-** | **-** | **-** | **-** | **1,214,235** |
| | | | | | | | |
| Segment liabilities | 79,989 | 7,273 | 39,862 | 32,027 | 76,322 | 23,610 | **259,083** |
| Inter-segment balances | (42,193) | (4,343) | (2,228) | (14,225) | (16,745) | (12,903) | **(92,637)** |
| **Total segment liabilities** | **37,796** | **2,930** | **37,634** | **17,802** | **59,577** | **10,707** | **166,446** |
| Current and deferred tax liabilities | - | - | - | - | - | - | 63,773 |
| Non-current and current debt | - | - | - | - | - | - | 127,493 |
| **Total liabilities** | **-** | **-** | **-** | **-** | **-** | **-** | **357,712** |

(in millions of Russian Roubles)

**Note 6: Segment information (continued)**

***Previous basis***

**As at 31 December 2005**

| | Hydro and thermal generating stations | Transmission | Energos | Unallocated companies | Total |
|---|---|---|---|---|---|
| Segment assets | 198,303 | 169,268 | 788,096 | 362,853 | **1,518,520** |
| Inter-segment balances | (7,055) | (1,808) | (14,204) | (299,767) | **(322,834)** |
| **Total segment assets** | **191,248** | **167,460** | **773,892** | **63,086** | 1,195,686 |
| Investments in associates | - | - | 1,061 | 4,210 | **5,271** |
| Current and deferred tax assets | - | - | - | - | **13,278** |
| **Total assets** | **-** | **-** | **-** | **-** | **1,214,235** |
| Segment liabilities | 30,516 | 6,821 | 162,973 | 23,014 | **223,324** |
| Inter-segment balances | (17,835) | (4,169) | (22,016) | (12,857) | **(56,877)** |
| **Total segment liabilities** | **12,681** | **2,652** | **140,957** | **10,157** | 166,447 |
| Current and deferred tax liabilities | - | - | - | - | **63,773** |
| Non-current and current debt | - | - | - | - | **127,492** |
| **Total liabilities** | **-** | **-** | **-** | **-** | **357,712** |

***Previous basis***

**As at 31 December 2004**

| | Hydro and thermal generating stations | Transmission | Energos | Unallocated companies | Total |
|---|---|---|---|---|---|
| Segment assets | 163,366 | 146,858 | 745,109 | 349,932 | **1,405,265** |
| Inter-segment balances | (705) | (529) | (10,025) | (276,911) | **(288,170)** |
| **Total segment assets** | **162,661** | **146,329** | **735,084** | **73,021** | 1,117,095 |
| Investments in associates | - | - | 1,030 | - | **1,030** |
| Current and deferred tax assets | - | - | - | - | **8,873** |
| **Total assets** | **-** | **-** | **-** | **-** | **1,126,998** |
| Segment liabilities | 33,065 | 3,585 | 121,870 | 35,761 | **194,281** |
| Inter-segment balances | (19,324) | (2,191) | (16,464) | (17,390) | **(55,369)** |
| **Total segment liabilities** | **13,741** | **1,394** | **105,406** | **18,371** | 138,912 |
| Current and deferred tax liabilities | - | - | - | - | **60,806** |
| Non-current and current det | - | - | - | - | **85,996** |
| **Total liabilities** | **-** | **-** | **-** | **-** | **285,714** |

***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 the purpose of 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

(in millions of Russian Roubles)

## Note 6: Segment information (continued)

newly restructured Energos related to the transmission segment are split by geographical regions. The Group's assets generate revenues primarily within the geographical region where they are located.

| | Revenue | | Segment assets | | Capital expenditure | |
|---|---|---|---|---|---|---|
| | Year ended 31 December 2005 | Year ended 31 December 2004 | As at 31 December 2005 | As at 31 December 2004 | Year ended 31 December 2005 | Year ended 31 December 2004 |
| **Transmission segment** | 7,186 | 5,735 | 167,460 | 148,498 | 22,087 | 17,601 |
| **Centre** | 243,738 | 214,522 | 275,913 | 262,762 | 28,435 | 25,097 |
| **North-West** | 79,036 | 71,575 | 117,936 | 95,526 | 19,701 | 12,120 |
| **Urals** | 149,865 | 144,654 | 194,907 | 187,468 | 13,311 | 9,443 |
| **Siberia** | 86,587 | 74,123 | 133,934 | 128,771 | 11,642 | 8,217 |
| **Volga** | 71,652 | 55,839 | 75,928 | 59,834 | 6,836 | 4,941 |
| **Far-East** | 58,783 | 55,498 | 121,031 | 117,880 | 14,311 | 11,576 |
| **South** | 44,778 | 38,846 | 71,376 | 70,993 | 8,303 | 9,119 |
| **Unallocated** | 25,280 | 18,865 | 37,201 | 45,363 | 2,780 | 1,298 |
| **Total** | **766,905** | **679,657** | **1,195,686** | **1,117,095** | **127,406** | **99,412** |

## Note 7: Related parties

***Associates.*** The following transactions were carried out with associates; the majority of which are based on tariffs set by FST and RSTs:

| | Year ended 31 December 2005 | Year ended 31 December 2004 |
|---|---|---|
| Electricity and heating revenues | 8,023 | 8,516 |
| Purchased power expenses | 2,200 | - |

For outstanding balance of associates see Note 12 and Note 19.

In 2004, the Group issued a loan to an associate of the Group, OAO Rossiskiye Kommunalniye Sistemy (“RKS”), for the amount of RR 493 million bearing interest of 13 percent per annum. The loan is to be repaid in 2006. As at 31 December 2005 the outstanding recoverable balance of RR 493 million is included within other current assets.

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

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

| | Year ended 31 December 2005 | Year ended 31 December 2004 |
|---|---|---|
| Electricity and heating revenues | 300,873 | 270,410 |
| Electricity and heating distribution expenses | 10,410 | 6,871 |
| Fuel expenses | 120,114 | 106,383 |
| Purchased power expenses | 68,054 | 64,051 |
| Interest expense | 1,651 | 1,590 |

(in millions of Russian Roubles)

**Note 7: Related parties (continued)**

| | 31 December 2005 | 31 December 2004 |
|---|---|---|
| Accounts receivable and prepayments | 62,933 | 58,489 |
| Accounts payable and accrued charges | 27,195 | 19,203 |
| Non-current and current debt | 46,960 | 36,051 |

Tax balances are disclosed in Notes 10, 12, 19 and 20. Tax transactions are disclosed in the statement of operations (see Notes 15 and 23).

During the year ended 31 December 2005 the federal government of the Russian Federation and regional governments gave financial assistance to RAO UES Group entities equal to RR 4,076 million (for the year ended 31 December 2004: RR 6,713 million). The assistance in respect of these periods has been recorded as electricity revenue in the statement of operations (see Note 22).

***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 period 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 paid to the state.

Members of the Board of Directors and the Management Board of RAO UES received the following remuneration:

| | Year ended 31 December 2005 | Year ended 31 December 2004 |
|---|---|---|
| Salaries and bonuses | 465 | 804 |
| Severance benefits | 49 | 6 |
| Other | 66 | 29 |
| **Total** | **580** | **839** |

***Employee share option plan.*** In June 2004, the Board of Directors approved a Share Option Plan for the employees of RAO UES (hereinafter the Plan).

The Plan provides for the granting of share options to the members of the Management Board and other key employees of RAO UES (hereinafter the Plan participants).

The Plan participants will be rewarded under the plan for their work in RAO UES over the period of 3 years, starting from 25 June 2004.

In February 2005, the Board of Directors of RAO UES approved a number of changes relating to the list of Plan participants and to the number of shares allocated under the Plan. Key employees from certain Group entities were included into the list.

A total of up to 418,657,600 ordinary shares (or about one percent of the issued ordinary shares of RAO UES) may be allocated under the Plan. 213,671,372 shares are allocated for granting share options to the members of the Management Board, the remainder to the other key employees of RAO UES.

(in millions of Russian Roubles)

**Note 7: Related parties (continued)**

Ordinary shares ultimately allocated under the Plan are allocated from treasury shares purchased by the Group for that purpose on the open market by a special-purpose entity, which is controlled by the Group. The treasury shares held for the purpose of the Plan will have no voting rights, unless otherwise decided by the Board of Directors.

In the event that the restructuring of RAO UES is completed prior to the exercise date of the share options, the Plan participants will be entitled to purchase shares in successor entities or other securities, distributed among the RAO UES shareholders.

The number of shares, which the Plan participants may purchase as part of implementation of the Plan, in the event that the Plan participant has terminated its employment with the Group entity before 25 June 2007, will be calculated proportionally based on the number of days worked prior to terminating the employment. In case of breaching certain defined provisions of the labour agreement and termination of employment at the initiative of the Group entity, the Plan participants will lose their right to purchase the shares.

The exercise price of the share option is USD 0.2934 per share, which is the weighted average price of the shares of RAO UES on RTS over the period of 25 June 2003 through 24 June 2004. For Plan participants who joined Group entities after 25 June 2004, the exercise price of the share option is the weighted average price of the shares of RAO UES on RTS one year before the date of the labour agreement. In addition to the exercise price, the Plan participants, who exercise their options, must reimburse part of the interest expenses paid on borrowings, which can be attracted for the purpose of purchases of the shares.

One of the vesting terms of the share options is prepayment by the members of the Management Board (in the amount of 10 percent of the share option agreement) and by other key employees (in the amount of 0,2 percent of the share option agreement). In the event that realization of the share option lapses, the prepayment will be returned to the Plan participant in full.

The Plan participant can exercise the share option at any time over the period from 25 June 2007 through 25 January 2008.

In 2004, the Group issued to the members of the Management Board non-interest bearing loans, which should be used by individuals to make prepayments under the share option agreements. The loans are issued for a period of 5 years. As at 31 December 2005 the amount of loans issued to employees amounted to RR 155 million.

As at 31 December 2005, in the course of the Plan implementation the Group had purchased 418,657,600 treasury shares. Their purchase cost was RR 3,571 million.

As at 31 December 2005, the number of outstanding share options was 381,436,585 (as at 31 December 2004: 365,365,878 options). The Group granted 16,070,707 options during 2005.

The fair values of services received in return for share options granted to employees are measured by reference to the fair value of share options granted. The estimate of the fair value of the services received is measured based on the Black-Scholes model.

| | |
|---|---:|
| Share price | 0.2770 USD |
| Exercise price | 0.2934 USD |
| Expected volatility | 31% |
| Option life | 1,095 days |
| Risk-free interest rate | 3.16% |
| **Fair value at measurement date** | **0.0690 USD** |

The measure of volatility used in option pricing model is the annualised standard deviation of the continuously compounded rates of return on the share over a period of time. Volatility has been determined on the basis of the historical volatility of the share price over the most recent period (one year before grant date). For share options outstanding as at 31 December 2005 the range of exercise prices lies between USD 0.2827 per share and USD 0.2934 per share, weighted average remaining contractual life is 757 days.

During the year ended 31 December 2005, the Group recognised an expense of RR 271 million related to the fair value of the options.

(in millions of Russian Roubles)

## Note 8: Property, plant and equipment

**Cost**

| | Electricity and heat generation | Electricity transmission | Electricity distribution | Heating networks | Construction in progress | Other | Total |
|---|---|---|---|---|---|---|---|
| Opening balance as at 31 December 2004 | 770,823 | 253,930 | 728,264 | 135,905 | 191,866 | 254,731 | 2,335,519 |
| Additions through acquisition of subsidiaries | 1,688 | 29 | 1,601 | 2 | 294 | 730 | 4,344 |
| Additions | 3,678 | 2,678 | 3,705 | 1,509 | 101,846 | 13,990 | 127,406 |
| Transfers | 36,177 | 9,365 | 21,677 | 6,093 | (88,790) | 15,478 | - |
| Disposals | (4,072) | (502) | (3,083) | (700) | (10,183) | (5,788) | (24,328) |
| Disposals to associates | (1,392) | - | (74) | (1,453) | (89) | (935) | (3,943) |
| Closing balance as at 31 December 2005 | 806,902 | 265,500 | 752,090 | 141,356 | 194,944 | 278,206 | 2,438,998 |
| **Accumulated depreciation (including impairment)** | | | | | | | |
| Opening balance as at 31 December 2004 | (474,696) | (139,905) | (518,869) | (97,301) | (23,294) | (188,573) | (1,442,638) |
| Charge for the period | (17,643) | (12,491) | (14,981) | (4,408) | - | (20,146) | (69,669) |
| Impairment charge | (46) | - | (4) | - | (4,241) | (168) | (4,459) |
| Disposals | 2,902 | 363 | 2,220 | 475 | 3,126 | 5,600 | 14,686 |
| Disposals to associates | 238 | - | 40 | 552 | - | 339 | 1,169 |
| Closing balance as at 31 December 2005 | (489,245) | (152,033) | (531,594) | (100,682) | (24,409) | (202,948) | (1,500,911) |
| Net book value as at 31 December 2005 | 317,657 | 113,467 | 220,496 | 40,674 | 170,535 | 75,258 | 938,087 |
| Net book value as at 31 December 2004 | 296,127 | 114,025 | 209,395 | 38,604 | 168,572 | 66,158 | 892,881 |

(in millions of Russian Roubles)

**Note 8: Property, plant and equipment (continued)**

**Cost**

| | Electricity and heat generation | Electricity transmission | Electricity distribution | Heating networks | Construction in progress | Other | Total |
|---|---|---|---|---|---|---|---|
| Opening balance as at 31 December 2003 | 746,298 | 229,353 | 716,449 | 129,692 | 205,590 | 243,509 | 2,270,891 |
| Additions | 1,986 | 2,637 | 1,476 | 374 | 88,489 | 4,450 | 99,412 |
| Transfers | 30,365 | 23,426 | 19,479 | 7,686 | (95,296) | 14,340 | - |
| Disposals | (3,871) | (1,486) | (2,963) | (1,528) | (6,625) | (6,636) | (23,109) |
| Disposals to associates | (3,955) | - | (6,177) | (319) | (292) | (932) | (11,675) |
| Closing balance as at 31 December 2004 | 770,823 | 253,930 | 728,264 | 135,905 | 191,866 | 254,731 | 2,335,519 |
| **Accumulated depreciation (including impairment)** | | | | | | | |
| Opening balance as at 31 December 2003 | (462,352) | (131,279) | (509,391) | (93,870) | (25,595) | (176,225) | (1,398,712) |
| Charge for the period | (16,615) | (9,157) | (16,320) | (4,842) | - | (18,497) | (65,431) |
| Impairment charge | (216) | (629) | - | - | (2,811) | (31) | (3,687) |
| Transfers | (2,403) | (1) | (955) | (235) | 4,564 | (970) | - |
| Disposals | 3,662 | 1,161 | 2,828 | 1,329 | 505 | 6,336 | 15,821 |
| Disposals to associates | 3,228 | - | 4,969 | 317 | 43 | 814 | 9,371 |
| Closing balance as at 31 December 2004 | (474,696) | (139,905) | (518,869) | (97,301) | (23,294) | (188,573) | (1,442,638) |
| Net book value as at 31 December 2004 | 296,127 | 114,025 | 209,395 | 38,604 | 168,572 | 66,158 | 892,881 |
| Net book value as at 31 December 2003 | 283,946 | 98,074 | 207,058 | 35,822 | 179,995 | 67,284 | 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.

Depreciation is charged once an asset is available for service.

Other property, plant and equipment include 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 formalise the right for rent. According to Russian legislation the expiry date of this option is 1 January 2008. As at 31 December 2005, 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 transactions. Non-cash transactions in respect of property, plant and equipment are:

| | Year ended 31 December 2005 | Year ended 31 December 2004 |
|---|---|---|
| Non-cash acquisitions | 8,932 | 14,089 |
| Non-cash proceeds from the sale of property, plant and equipment | 2,280 | 2,091 |

***Impairment.*** 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.

Based on factors set out below management believes that there was no indication of any additional impairment on the

(in millions of Russian Roubles)

### Note 8: Property, plant and equipment (continued)

Group's principal operating assets:

- increase in electricity tariffs set for RAO UES Group for 2005 were on average 11 % (heat: 13%);
- growth of gas prices set in the Government's forecast is not expected to exceed limit of 11 % in 2006, which is not significantly more than expected inflation;
- demand for both electricity and heat is consistently growing from year to year;
- the Group's restructuring did not change the manner of recovery of the assets – the regulator allocated previously single tariffs for electricity and heat set for a vertically integrated power companies among newly created companies.

In the year 2005 the Group recognised an impairment loss of RR 4,459 million in respect of certain fixed assets and construction in progress (in 2004: RR 3,687 million). The impairment loss recognised in 2005 substantially related to assets located in the Chechen Republic. As a consequence of the military, political and economic situation in the Chechen Republic, the Group believes it will be unable to generate positive cash flow from the operations of its assets in the Chechen Republic for the foreseeable future.

***Leased property, plant and equipment***

The Group leased certain equipment under a number of finance lease agreements. At the end of each of the leases the Group has the option to purchase the equipment at a beneficial price. At 31 December 2005 the net book value of leased property, plant and equipment was RR 7,028 million. The leased equipment secures lease obligations.

***Operating leases***

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

Operating lease rentals are payable as follows:

| | **31 December 2005** |
|---|---|
| Less than one year | 2,936 |
| Between one year and five years | 7,532 |
| After five years | 35,246 |
| **Total** | **45,714** |

### Note 9: Investments in associates and jointly controlled entity

The Group has investments in a number of associated enterprises, which are incorporated and operate in the Russian Federation. The Group also has an investment in the jointly controlled entity which operates in Kazakhstan.

| | **Kurganenergo** | **Heat and Power Company** | **Power Machines** | **Stantsiya Ekibastuzskaya GRES-2** | **Total** |
|---|---|---|---|---|---|
| **Carrying value as at 31 December 2004** | **1,030** | **-** | **-** | **-** | **1,030** |
| Deconsolidation of Heat and Power Company | - | 430 | - | - | 430 |
| Acquisitions of associate and jointly controlled entity | - | - | 3,176 | 695 | 3,871 |
| Share of profit/(loss) of associates and jointly controlled entity | 31 | 48 | (44) | (95) | (60) |
| **Carrying value as at 31 December 2005** | **1,061** | **478** | **3,132** | **600** | **5,271** |

(in millions of Russian Roubles)

**Note 9: Investments in associates and jointly controlled entity (continued)**

As at 31 December 2005 and 31 December 2004 the carrying value of Group's investment in Rossiyskie Kommunalnye Sistemy is nil.

During 2004 management re-assessed the level of control that the Group had over Kurganenergo and determined that control no longer exists, and that the Group exercises significant influence over Kurganenergo. Consequently, the investment in Kurganenergo is accounted for as an investment in an associate.

During 2005 the Group determined that control over Heat and Power Company no longer existed due to the dilution of the Group's share. However, the Group does exercise significant influence over Heat and Power Company and, consequently, as at 31 December 2005 the investment in Heat and Power Company has been accounted for as an investment in associate.

The following is summarised financial information, in aggregate, in respect of the associates and the jointly controlled entity:

| | Ownership % | Voting % | Assets | Liabilities |
|---|---|---|---|---|
| **As at 31 December 2004** | | | | |
| Rossiyskie Kommunalnye Sistemy | 25.0 | 25.0 | 5,255 | (5,558) |
| Kurganenergo | 49.0 | 49.0 | 3,788 | (1,686) |
| **As at 31 December 2005** | | | | |
| Rossiyskie Kommunalnye Sistemy | 25.0 | 25.0 | 8,796 | (8,616) |
| Kurganenergo | 49.0 | 49.0 | 3,603 | (1,438) |
| Heat and Power Company | 25.0 | 28.2 | 3,095 | (1,190) |
| Stantsiya Ekibastuzskaya GRES-2 | 30.0 | 50.0 | 2,769 | (268) |
| Power Machines | 23.8 | 25.0 | 26,231 | (13,125) |

| | Revenues | Expenses | (Loss) / Profit |
|---|---|---|---|
| **Year ended 31 December 2004** | | | |
| Rossiyskie Kommunalnye Sistemy | 13,352 | (14,439) | (1,087) |
| Kurganenergo | 4,464 | (3,976) | 488 |
| **Year ended 31 December 2005** | | | |
| Rossiyskie Kommunalnye Sistemy | 15,913 | (16,098) | (185) |
| Kurganenergo | 4,688 | (4,626) | 62 |
| Heat and Power Company | 2,463 | (2,121) | 342 |
| Stantsiya Ekibastuzskaya GRES-2 | 1,387 | (1,414) | (27) |
| Power Machines | 18,872 | (20,018) | (1,146) |

***Acquisition of OAO Stantsiya Ekibastuzskaya GRES-2***

In July 2005, Inter RAO UES, a Group entity, acquired 50.0 percent of the shares of OAO Stantsiya Ekibastuzskaya GRES-2 (Kazakhstan). The total consideration of RR 288 million (USD 10 million) was paid by settlement of a debt owed by the vendor for electricity supplied by the Group to Kazakhstan in 1992-1996.

Management assessed the level of control that the Group has over Stantsiya Ekibastuzskaya GRES-2 and determined that control did not exist. The ownership of Stantsiya Ekibastuzskaya GRES-2 represents a jointly controlled entity and the Group applies the equity accounting method to recognise its investment.

Negative goodwill arising on acquisition is included in the statement of operations.

***Acquisition of OAO Power Machines Group***

In December 2005 RAO UES acquired 22.4 percent of the share capital of OAO Power Machines Group ("Power Machines"). As at the acquisition date one of the Group entities held a further 2.6 percent of the share capital of Power Machines and, consequently, the Group has built a blocking stake (25 percent plus one share). The principal

(in millions of Russian Roubles)

**Note 9: Investments in associates and jointly controlled entity (continued)**

activity of Power Machines is the manufacture and supply of equipment for hydro, steam, gas and nuclear power plants.

The purchase consideration comprised cash paid of RR 2,939 million. Management’s purchase accounting allocation is preliminary and resulted in no goodwill being recognized. The Group plans to perform an evaluation of the identifiable non-current assets by contracting an independent professional appraiser.

In February 2006, pursuant to a share sales purchase agreement the Group signed a pledge agreement with the EBRD for 550,820,431 shares or 7.6 percent of the share capital of Power Machines as a security for a credit line facility issued to Power Machines on 1 March 2004.

The market price of Power Machines shares as at 31 December 2005 was RR 2,24 per share.

**Note 10: Other non-current assets**

| | 31 December 2005 | 31 December 2004 |
|---|---|---|
| Available-for-sale investments (carried at cost) | 4,398 | 4,866 |
| Available-for-sale investments (carried at fair value) | 3,517 | 2,996 |
| Advances to contractors | 15,570 | 17,306 |
| Restructured trade receivables (Net of allowance for doubtful debtors of RR 2,081 million as at 31 December 2005 and RR 4,169 million as at 31 December 2004) | 1,901 | 2,200 |
| Non-current portion of value added tax recoverable | 6,432 | 6,878 |
| Other (Net of allowance of RR 579 million as at 31 December 2005 and 865 million as at 31 December 2004) | 10,257 | 5,193 |
| **Total** | **42,075** | **39,439** |

**Note 11: Cash and cash equivalents**

| | 31 December 2005 | 31 December 2004 |
|---|---|---|
| Cash at bank and in hand | 30,497 | 22,413 |
| Cash equivalents | 6,474 | 12,880 |
| Foreign currency accounts | 154 | 551 |
| **Total** | **37,125** | **35,844** |

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

**Note 12: Accounts receivable and prepayments**

| | 31 December 2005 | 31 December 2004 |
|---|---|---|
| Trade receivables (Net of allowance for doubtful debtors of RR 50,567 million as at 31 December 2005 and RR 36,003 million as at 31 December 2004) | 48,157 | 44,271 |
| Value added tax recoverable | 34,237 | 22,062 |
| Advances to suppliers and prepayments | 15,228 | 13,224 |
| Receivables from associates | 1,484 | 1,809 |
| Other receivables (Net of allowance for doubtful debtors of RR 4,793 million as at 31 December 2005 and RR 6,491 million as at 31 December 2004) | 30,852 | 22,998 |
| **Total** | **129,958** | **104,364** |

As at 31 December 2005 and 31 December 2004, the above other receivables balance included RR 13,698 million and RR 7,555 million of tax prepayments, respectively, which are to be settled against future tax liabilities.

(in millions of Russian Roubles)

## Note 12: Accounts receivable and prepayments (continued)

Management has determined the allowance for doubtful debtors based on specific customer identification, customer payment trends, subsequent receipts and settlements and the analysis of expected future cash flows. Based on the expected collection rate, discount rates of 11-19 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, and that therefore, the recorded value approximates their fair value.

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 10). The loss on restructuring is included in doubtful debtors expense.

## Note 13: Inventories

| | 31 December 2005 | 31 December 2004 |
|---|---|---|
| Materials and supplies | 25,108 | 24,736 |
| Fuel production stocks | 16,957 | 15,656 |
| Other inventories | 2,129 | 1,564 |
| **Total** | **44,194** | **41,956** |

The above inventory balances are recorded net of an obsolescence provision of RR 2,374 million and RR 2,185 million as at 31 December 2005 and 31 December 2004, respectively.

As at 31 December 2005 and 31 December 2004, the inventory balance included RR 11,841 million and RR 16,502 million, respectively, of inventory pledged as collateral under loan agreements.

## Note 14: Equity

***Share Capital***

| | Number of shares issued and fully paid | 31 December 2005 | 31 December 2004 |
|---|---|---|---|
| Ordinary shares | 41,041,753,984 | 147,439 | 147,439 |
| Preference shares | 2,075,149,384 | 7,667 | 7,667 |
| **Total** | **43,116,903,368** | **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 RR 0.5. The carrying amount of share capital has been adjusted to take into account the effects of hyperinflation that existed in Russian Federation until the end of 2002.

***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.

***Increase of minority interest due to the restructuring*** During the year ended 31 December 2005 state registration of new entities created as a result of reorganization of subsidiaries of RAO UES was completed.

The owners of preference shares of the reorganized subsidiaries received additional preference shares of the newly created entities, since their share capital was formed from the shareholders’ funds of the reorganized subsidiaries (including additional paid-in capital and retained earnings).

In accordance with the Group accounting policy (see Note 4) special rights of the owners of preference shares are taken into account in calculating minority interest: as the owners of preference shares have the right to the liquidation (nominal) value of their preference shares upon liquidation of the entities and also to participate in the distribution of the assets of the liquidated entities.

(in millions of Russian Roubles)

**Note 14: Equity (continued)**

The increase in the total amount of preference shares in issue in Group entities and related increase of their liquidation (nominal) value resulted in the increase of minority interest. This increase is shown as "Changes in Group Structure" in the Statement of Changes in Equity for the year ended 31 December 2005.

***Dividends.*** The annual statutory accounts of the parent company, RAO UES, form the basis for the annual profit distribution and other appropriations. The specific Russian legislation identifies the basis of distribution as the net profit. For 2005, the statutory profit for the parent company, RAO UES, as reported in the published statutory reporting forms, was RR 20,898 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 2006 in respect of the year ended 31 December 2005 of RR 0.0574 per ordinary share and RR 0.1939 per preference share.

A dividend was declared in 2005 in respect of the year ended 31 December 2004 of RR 0.0559 per ordinary share and RR 0.2233 per preference share.

***Treasury shares***. The Group periodically purchases and sells treasury shares. Treasury shares as at 31 December 2005 represent 450,328,437 (31 December 2004: 467,812,021) ordinary shares and 6,696,727 (31 December 2004: 14,968,763) preference shares.

***Treasury shares***

| | Cost as at 31 December 2004 | Purchases and disposals, net | Cost as at 31 December 2005 |
|---|---|---|---|
| Ordinary shares | 3,871 | (182) | 3,689 |
| Preference shares | 54 | (36) | 18 |
| **Total** | **3,925** | **(218)** | **3,707** |

***Other reserves:***

***Fair value reserve for available for sale investments.*** In the reporting period, the Group retrospectively corrected an error relating to the accounting for certain available for sale investments, whose value declined significantly in 2002-2003. Originally, this decline in value in a total amount of RR 4,988 million was recognised in the fair value reserve. In management's view this decline should have been correctly treated as impairment and recognised in the statement of operations. As a result of the correction, the fair value reserve for available for sale investments was retrospectively increased and retained earnings decreased by that amount. The correction did not have any impact on the profit or total equity of the periods presented.

***Translation reserve.*** The translation reserve, relating to the exchange differences arising on translation of the net assets of foreign subsidiaries, as at 31 December 2005 was a debit of RR 538 million (31 December 2004: a debit of RR 268 million) and is included in retained earnings and other reserves.

**Note 15: Profit tax**

***Profit tax charge***

| | Year ended 31 December 2005 | Year ended 31 December 2004 |
|---|---|---|
| Current profit tax charge | (28,867) | (24,151) |
| Deferred profit tax (charge)/benefit | (291) | 4,054 |
| **Total profit tax charge** | **(29,158)** | **(20,097)** |

During the year ended 31 December 2005 most members of the Group were subject to profit tax rates of 24 percent on taxable profit.

(in millions of Russian Roubles)

**Note 15: Profit tax (continued)**

In accordance with 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.

| | Year ended 31 December 2005 | Year ended 31 December 2004 |
|---|---|---|
| **Profit before profit tax** | 53,132 | 62,947 |
| Theoretical profit tax charge at an average statutory tax rate of 24 percent | (12,752) | (15,107) |
| Tax effect of items which are not deductible or assessable for taxation purposes: | | |
| Tax interest and penalties release | 2,693 | 1,749 |
| Other non-deductible and non-taxable items, net | (12,850) | (8,408) |
| Effect of statutory revaluation on tax base | (272) | 467 |
| Non-recognised deferred tax assets movements | 3,795 | 2,079 |
| Other | (2,182) | (877) |
| **Total profit tax charge** | **(29,158)** | **(20,097)** |

***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***

| | 31 December 2004 | Movement for the period recognised in the statement of operations | Effect of acquisition of subsidiaries | 31 December 2005 |
|---|---|---|---|---|
| Trade receivables | (6,151) | 950 | - | (5,201) |
| Property, plant and equipment | 63,387 | (3,259) | - | 60,128 |
| Losses carried forward | (631) | 19 | - | (612) |
| Other | (514) | 2,021 | 97 | 1,604 |
| **Total** | **56,091** | **(269)** | **97** | **55,919** |

***Deferred profit tax assets***

| | 31 December 2004 | Movement for the period recognised in the statement of operations | 31 December 2005 |
|---|---|---|---|
| Allowance for doubtful debtors | 2,123 | 3,522 | 5,645 |
| Property, plant and equipment | 10,076 | (1,032) | 9,044 |
| Losses carried forward | 505 | 307 | 812 |
| Other | (73) | 505 | 432 |
| Deferred profit tax assets | 12,631 | 3,302 | 15,933 |
| Less: non-recognized deferred tax assets | (6,694) | (3,795) | (10,482) |
| **Total** | **5,937** | **(493)** | **5,444** |

Temporary differences on property, plant and equipment relate to differences in depreciation rates, adoption of IAS 29, IAS 36 and statutory revaluation (at extent accepted for tax purposes).

As at 31 December 2005 and 31 December 2004 the Group has not recognized a deferred tax liability in respect of temporary differences associated with investments in all its subsidiaries that may crystallize depending on how the RAO UES restructuring is effected in the future. The Group is able to control the timing of the reversal of these

(in millions of Russian Roubles)

**Note 15: Profit tax (continued)**

temporary differences as it intends to perform the restructuring in a manner that would substantially avoid crystallizing any additional tax liabilities and therefore it is probable that the temporary differences will not reverse in the foreseeable future. Potential deferred tax liability in respect of the temporary differences could vary from zero to RR 82 billion depending on the specific methods used to complete the RAO UES restructuring. Where management currently envisages changes triggering taxable events, the deferred tax consequence has been recognised. In the year ended 31 December 2005 an additional deferred tax liability of RR 600 million was recognised in respect of such taxable events.

The Group did not recognise deferred tax assets in the amount RR 10,489 million because it is not probable that future taxable profits will be available against which the Group can utilize the benefits therefrom.

Tax losses can be carried forward for a maximum of 10 years.

**Note 16: Non-current debt**

| | Currency | Effective interest rate | Due | 31 December 2005 | 31 December 2004 |
|---|---|---|---|---|---|
| Central and regional government loan | USD | LIBOR+3% | 2034 | 2,459 | 2,772 |
| Bonds issued by subsidiaries | RR | 7.1%-11% | 2006-2010 | 22,678 | 9,359 |
| Bonds issued by RAO HO | RR | 5%-10% | 2005 | - | 3,000 |
| Bank debt from foreign banks | EUR | EURIBOR+4.25% | 2010 | 1,231 | 1,361 |
| Bank debt from foreign banks | USD | LIBOR+4% | 2009 | 647 | 1,260 |
| Bank debt from foreign banks | USD | LIBOR+3.5% | 2007 | 906 | 780 |
| Bank debt from foreign banks | USD | RF30+2.5% | 2010 | 1,119 | - |
| Bank debt from Russian banks | RR | 10%-15% | 2006-2011 | 10,658 | 4,467 |
| Bank debt from Russian banks | USD | LIBOR+2.5% | 2008 | 432 | 1,249 |
| Finance lease liability | RR | - | - | 4,617 | - |
| Other long-term debt | | | | 4,140 | 3,177 |
| Total non-current debt | | | | 48,887 | 27,425 |
| Less: current portion of non-current debt | | | | (10,095) | (7,378) |
| **Total** | | | | **38,792** | **20,047** |

***Maturity table***

| | 31 December 2005 | 31 December 2004 |
|---|---|---|
| **Due for repayment** | | |
| Between one and two years | 13,213 | 4,163 |
| Between two and three years | 9,781 | 11,020 |
| Between three and four years | 2,584 | 1,847 |
| Between four and five years | 9,077 | 1,233 |
| After five years | 4,137 | 1,784 |
| **Total** | **38,792** | **20,047** |

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.

(in millions of Russian Roubles)

### Note 16: Non-current debt (continued)

In addition, the Group had undrawn committed financing facilities of RR 4,087 million which may be used for the general purposes of the Group.

***Leasing.*** Lease liabilities are effectively secured as the rights to the leased asset revert to the lessor in the event of default.

| **Finance lease liabilities – minimum lease payments** | **31 December 2005** |
|---|---|
| **Due for repayment** | |
| Less than one year | 1,105 |
| Between one year and five years | 4,863 |
| After five years | 588 |
| | **6,556** |
| Future finance charges on finance lease | (1,202) |
| **Present value of lease liabilities** | **5,354** |

At the balance sheet date, the estimated fair value of total non-current debt (including the current portion) was RR 48,388 million (31 December 2004: RR 27,652 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

| | **31 December 2005** | **31 December 2004** |
|---|---|---|
| Taxes | 3,176 | 12,010 |
| Pension liability | 9,253 | 5,113 |
| Other non-current liabilities | 1,238 | 1,669 |
| Total other non-current liabilities | 13,667 | 18,792 |
| Less: current portion of restructured liabilities | (860) | (1,757) |
| **Total** | **12,807** | **17,035** |

Information about the pension liability for the year ended 31 December 2005 and 31 December 2004 is disclosed in Note 21.

In accordance with Government Resolution No. 1002 dated 3 September 1999, the majority of Group entities 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 rate of 21-24 percent has been used in the estimate of the fair value of these liabilities at the date of restructuring.

The maturity profile is as follows:

| ***Maturity table*** | **31 December 2005** | **31 December 2004** |
|---|---|---|
| **Due for repayment** | | |
| Between one and two years | 1,356 | 2,430 |
| Between two and five years | 1,040 | 6,553 |
| After five years | 10,411 | 8,052 |
| **Total** | **12,807** | **17,035** |

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

| | **Effective interest rate** | **31 December 2005** | **31 December 2004** |
|---|---|---|---|
| Current debt | 5.0% - 15.0% | 77,869 | 58,571 |
| Current portion of non-current debt | | 10,095 | 7,378 |
| Current portion of finance lease liability | | 737 | - |
| **Total** | | **88,701** | **65,949** |

(in millions of Russian Roubles)

### Note 19: Accounts payable and accrued charges

| | 31 December 2005 | 31 December 2004 |
|---|---|---|
| Trade payables | 56,383 | 44,898 |
| Accrued liabilities and other creditors | 42,170 | 36,018 |
| Bills of exchange payable | 1,164 | 747 |
| Dividends payable | 2,342 | 1,898 |
| Current portion of trade payables and other creditors restructured to long-term | 268 | 304 |
| Payable to associates | 121 | - |
| **Total** | **102,448** | **83,865** |

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 24.

### Note 20: Taxes payable

| | 31 December 2005 | 31 December 2004 |
|---|---|---|
| Value added tax | 29,531 | 21,608 |
| Fines and interest | 10,646 | 8,217 |
| Profit tax | 7,854 | 4,715 |
| Property tax | 3,414 | 1,461 |
| Employee taxes | 2,767 | 2,294 |
| Other taxes | 4,241 | 2,979 |
| Current portion of taxes restructured to long-term | 592 | 1,453 |
| **Total** | **59,045** | **42,727** |

Included in the payable for value added tax is RR 22,453 million of deferred VAT which only becomes payable to the authorities when the underlying receivables balance is either recovered or written off (31 December 2004: RR 16,021 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 31 December 2005 and 31 December 2004 the refinance rate was 12 and 13 percent respectively. 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.

### Note 21: Pension benefits

The tables below provide information about the benefit obligations, plan assets and actuarial assumptions used for the years ended 31 December 2005 and 2004.

Amounts recognised in the Consolidated Balance Sheet:

| | 31 December 2005 | 31 December 2004 |
|---|---|---|
| Present value of funded defined benefit obligations | 16,807 | 7,540 |
| Less: Fair value of plan assets | (2,898) | (2,427) |
| Deficit in plan | 13,909 | 5,113 |
| Net actuarial loss not recognised in the balance sheet | (4,656) | - |
| **Net liability in the balance sheet** | **9,253** | **5,113** |

(in millions of Russian Roubles)

**Note 21: Pension benefits (continued)**

Amounts recognised in the Consolidated Statement of Operations:

| | Year ended 31 December 2005 | Year ended 31 December 2004 |
|---|---|---|
| Current service cost | 4,941 | 1,311 |
| Interest cost | 693 | 602 |
| Expected return on plan assets | (244) | (188) |
| **Total** | **5,390** | **1,725** |

Changes in the present value of the Group's defined benefit obligation and plan assets are as follows:

| | 31 December 2005 | 31 December 2004 |
|---|---|---|
| **Benefit obligations** | | |
| Benefit obligations as at 1 January 2005 | 7,540 | 6,565 |
| Current service cost | 4,941 | 1,311 |
| Interest cost | 693 | 602 |
| Actuarial loss/(gain) | 4,462 | (199) |
| Benefits paid | (829) | (739) |
| **Benefit obligations as at 31 December 2005** | **16,807** | **7,540** |
| **Plan assets** | | |
| Fair value of plan assets as at 1 January 2005 | 2,427 | 1,877 |
| Expected return on plan assets | 244 | 188 |
| Actuarial loss | (194) | (198) |
| Employer contributions | 1,250 | 1,300 |
| Benefits paid | (829) | (740) |
| **Fair value of plan assets as at 31 December 2005** | **2,898** | **2,427** |

Actual return on plan assets for the year 2005 was RR 50 million (for the year 2004: RR 10 million). Rate of return on plan assets was based on the yield of Russian government bonds, equity securities of Russian issuers and other investments.

The Group expects to contribute RR 2,030 million to the defined benefit plans in 2006.

Principal actuarial assumptions are as follows:

| | 31 December 2005 % | 31 December 2004 % |
|---|---|---|
| Discount rate | 6.9 | 9.7 |
| Expected return on plan assets | 10.0 | 10.0 |
| Salary increase | 7.0 | 7.1 |
| Pension increase | 5.0 | 5.0 |
| Average future working life (years) | 12.0 | 12.0 |

Life expectancies (at standard age of retirement) are as follows:

| | 31 December 2005 | 31 December 2004 |
|---|---|---|
| Male aged 60 | 14 | 14 |
| Female aged 55 | 23 | 23 |

(in millions of Russian Roubles)

## Note 21: Pension benefits (continued)

The plan assets allocation of the investment portfolio maintained by non-state pension funds was as follows:

| Type of assets | 31 December 2005 % | 31 December 2004 % |
|---|---|---|
| Equity securities of Russian issuers | 19.6 | 10.3 |
| Promissory notes of Russian issuers | 14.5 | 12.2 |
| Bank deposits | 1.1 | 3.1 |
| Russian government and municipal bonds | 23.9 | 21.5 |
| Russian corporate bonds | 22.1 | 26.6 |
| Other | 18.8 | 26.3 |
| **Total** | **100.0** | **100.0** |

## Note 22: Revenues

| | Year ended 31 December 2005 | Year ended 31 December 2004 |
|---|---|---|
| Electricity | 570,982 | 513,933 |
| Heating | 131,899 | 114,908 |
| Transmission | 14,138 | 5,993 |
| Other | 47,636 | 44,823 |
| **Total revenues** | **764,655** | **679,657** |

(in millions of Russian Roubles)

## Note 23: Operating expenses

| | Year ended 31 December 2005 | Year ended 31 December 2004 |
|---|---|---|
| Raw materials and consumables used, including | 241,794 | 201,022 |
| *Fuel expenses* | *221,032* | *186,777* |
| *Other materials* | *20,762* | *14,245* |
| Employee benefit expenses and payroll taxes | 129,229 | 104,994 |
| Third parties services, including | 86,046 | 72,898 |
| *Repairs and maintenance* | *53,043* | *47,124* |
| *Consulting, legal and information services* | *6,518* | *4,645* |
| *Insurance expense* | *5,500* | *5,044* |
| *Rent* | *5,213* | *4,925* |
| *Security services* | *4,433* | *3,247* |
| *Transportation services* | *3,727* | *2,875* |
| *Bank services* | *3,195* | *2,462* |
| *Commission fee* | *2,585* | *1,260* |
| *Telecommunication services* | *1,832* | *1,316* |
| Purchased power | 82,862 | 76,017 |
| Depreciation of property, plant and equipment | 69,801 | 65,492 |
| Electricity and heat distribution | 14,530 | 9,753 |
| Doubtful debtors expense | 10,013 | 4,848 |
| Other taxes | 9,549 | 12,173 |
| Water usage expenses | 8,572 | 8,598 |
| Impairment of property, plant and equipment | 4,459 | 3,687 |
| Fines and penalties, other than on taxes | 3,752 | 2,857 |
| Loss on disposal of fixed assets | 2,989 | 3,528 |
| Social expenditures | 2,252 | 1,678 |
| Charity expenses | 1,894 | 2,263 |
| Expenses related to restructuring process | 1,773 | 1,499 |
| Business trip expenses | 1,413 | 1,168 |
| Labor protection costs | 1,069 | 719 |
| Work performed by the Group and capitalised | (3,468) | (1,977) |
| Other expenses | 27,175 | 28,346 |
| **Total operating expenses** | **695,704** | **599,563** |

Doubtful debtors expenses are presented net of interest income for the year 2005 at the amount of RR 4,336 million (for the year 2004: RR 4,631 million) accrued on trade receivables.

## Note 24: Finance costs

| | Year ended 31 December 2005 | Year ended 31 December 2004 |
|---|---|---|
| Interest expense (debts) | (7,953) | (8,480) |
| Interest expense (release of prior period discounting) | (9,390) | (9,129) |
| Leasing finance charges | (437) | - |
| Foreign exchange (loss)/gain | (229) | 774 |
| **Total** | **(18,009)** | **(16,835)** |

The discounting of restructured payable amounts gives rise to a gain. Subsequent to its initial recognition, the discount is amortized over the period of the restructuring as an expense. Further information on the restructuring of accounts payable and taxes payable is contained in Notes 17, 19 and 20.

(in millions of Russian Roubles)

### Note 25: Earnings per share

| | Year ended 31 December 2005 | Year ended 31 December 2004 |
|---|---|---|
| Weighted average number of ordinary shares issued (thousands) | 41,041,754 | 41,041,754 |
| Weighted average number of preference shares issued (thousands) | 2,075,149 | 2,075,149 |
| Adjustment for weighted average number of treasury shares (thousands) | (475,163) | (135,035) |
| Weighted average number of ordinary and preference shares outstanding (thousands) | 42,641,740 | 42,981,868 |
| Profit attributable to the shareholders of RAO UES | 18,316 | 31,949 |
| Weighted average earnings per ordinary and preference share – basic and diluted (in RR) | 0.43 | 0.74 |

Taking into account the effect of the unequal dividends paid in the period (see Note 14), and based on the weighted average numbers of preference and ordinary shares outstanding, the earnings per share for the two classes of shares were as follows:

| | Year ended 31 December 2005 | Year ended 31 December 2004 |
|---|---|---|
| Weighted average number of ordinary shares issued (thousands) | 41,041,754 | 41,041,754 |
| Adjustment for weighted average number of ordinary treasury shares (thousands) | (462,826) | (118,345) |
| Weighted average number of ordinary shares outstanding (thousands) | 40,578,928 | 40,923,409 |
| Weighted average number of preference shares issued (thousands) | 2,075,149 | 2,075,149 |
| Adjustment for weighted average number of preference treasury shares (thousands) | (12,338) | (16,690) |
| Weighted average number of preference shares outstanding (thousands) | 2,062,811 | 2,058,459 |
| Dividends to ordinary shares outstanding | 2,294 | 1,925 |
| Dividends to preference shares outstanding | 464 | 474 |
| Total dividends | 2,758 | 2,399 |
| Total Profit attributable to ordinary equity holders less dividends paid | 15,559 | 29,550 |
| - attributable to ordinary shareholders | 14,806 | 28,135 |
| - attributable to preference shareholders | 753 | 1,415 |
| Total earnings attributable to the ordinary shareholders | 17,100 | 30,060 |
| Total earnings attributable to the preference shareholders | 1,216 | 1,889 |
| Earnings per ordinary share – basic and diluted (in RR) | 0.42 | 0.73 |
| Earnings per preference share – basic and diluted (in RR) | 0.59 | 0.92 |

### Note 26: Commitments

***Sales commitments.*** The Group has entered into two contracts with TOO Kazenergoresource, a contract with Belenergo, three contract with TPK Sirious, agreement with ZAO “Energijos realizacios centras” (Lithuania), Ost Elektra Gmbh (Germany), OAO Uralskenergo, Scaent AB (Sweden), AK “CREPS” (Mongolia), GAO “Latvenergo” (Latvia), two contracts with Fortum Power and Heat Oy (Finland), GUGT Mongolii (Mongolia), two contracts RAO Nordic OY, Union-D, Iantarenergo. Electricity sales under mentioned contracts for the year 2006 are expected to be as follows: USD 190 million; EUR 270 million and RR 2,327 million. For further periods sales volume and price are a subject for clarification with those companies, nevertheless estimated sales in frame of the signed contracts will be approximately the following: in 2007: USD 261 million and EUR 302 million; 2008: USD 206 million and EUR 270 million; other years: USD 1,692 million and EUR 672 million.

**Note 26: Commitments (continued)**

***Purchase commitment.*** The Group concluded agreements with its electricity suppliers Ekibastuzskaya GRES-2 (Kazakhstan), OAO Elektricheskie Stantsii (Kirgizstan), AES Ekibastuz (Kazakhstan), two contracts with TOO Kazenergoresurs (Kazakhstan), OAHK Barki Tochik (Tadjikistan) and AK CREPS (Mongolia), Access Energo. Electricity purchases under mentioned contracts are expected to be as follows for the year 2006: USD 63 million and RR 2,318 million. For further periods purchases volume and price are a subject for clarification with those companies, nevertheless estimated purchases in frame of the signed contracts will be approximately the following: in 2007: USD 68 million and RR 2,318 million; 2008: USD 52 million and RR 38 million; other years: USD 238 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 89,772 million as at 31 December 2005 and RR 46,555 million as at 31 December 2004.

**Note 27: 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.

Due to the fact, that the tax and other legislation do not fully cover all the aspects of the Group restructuring, there might be respective legal and tax risks.

Certain tax authorities have indicated that they believe that some Group entities, including OAO Mosenergo, may be liable for additional taxes on the basis that the subscription fees paid to RAO UES, SO-CDU and FGC for managing the transmission of electricity, dispatch functions and for development of the Group's strategy constitute financial aid, that property received as contribution to charter capital should be valued differently for tax purposes, and that expenses have been overstated by the amounts of abnormal losses of electricity dispatched etc.

Possible tax claims may also arise in connection with the tax treatment of income on distressed debt and the basis of tax accounting for certain capital transactions.

**Note 27: Contingencies (continued)**

No disclosure has been made in respect of the possible financial effect of potential claims or disputes on these matters, as this might seriously prejudice the position of the Group.

As at 31 December 2005 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 28: 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.

***Credit risk***. Financial assets which potentially subject Group entities to concentrations of credit risk consist principally of trade receivables including promissory notes. Credit risks related to trade receivables are systematically monitored and are considered when the allowance for doubtful debtors is made. The carrying amount of trade receivables, net of the allowance for doubtful debtors, represents the maximum amount exposed to credit risk. 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 (see Note 2).

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 RR. The major concentration of foreign exchange risk is in relation to foreign currency denominated sales and purchase commitments (see Note 26) and foreign currency denominated debt (see 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. Currently the Group does not operate a formal management program focusing on the unpredictability of financial markets or seeking to minimize potential adverse effects on the financial performance of the Group.

***Fair values***. The fair value of investments and borrowings is discussed in Note 14 and 16 respectively. Management believes that the fair value of other financial assets and financial liabilities is not significantly different from their carrying amounts.

**Note 29: Subsequent events**

On 23 December 2005 Mosenergo, a Group entity, concluded an agreement with the EBRD to open a credit line in the total amount of RR 7,200 million for more than 10 years. The first tranche was received on 21 March 2006 in the amount of RR 300 million. The loan was obtained for the purchase of additional equipment for the Group. The loan interest on loans is determined on Mosprime plus basis. According to the Loan Agreement the payment of interest on the loan will be carried out on a monthly basis, and the principal amount is to be repaid upon maturity.

In May 2006 RAO UES, OAO Federal hydro generating company and external investors concluded an agreement on mutual financing, construction and exploitation of Boguchanskaya GES and Boguchansky Aluminum Smelter. The

**Note 29: Subsequent events (continued)**

first phases of Boguchanskaya GES and Boguchansky Aluminum Smelter are planed to be put into operation in the fourth quarter of 2009. In the near future OAO Federal hydro generating company and the external investors plan to sign an additional co-investment agreement specifying obligations of the parties to finance this project.

In May 2006 RAO UES and the Moscow City Government concluded an agreement on cooperation in implementing of investing program to construct and modernize electric power facilities in the city of Moscow. Total anticipated investment to be contributed by the Group will be about RR 90 billion.

In July 2006 the Group conducted a tender for the sale of 100.0 percent of the shares of OAO Taimyrenergo. The winning party offered cash consideration of RR 7,290 million. The disposed assets belong to the Energo segment operating in the Siberia region. OAO Taimyrenergo's net assets at 31 December 2005 and 2004 were RR 1,233 million and RR 1,173 million, respectively. The results of the disposal will be reflected in the Group's statement of operations in 2006.