OPEN JOINT-STOCK COMPANY
TERRITORIAL GENERATING COMPANY № 1

INTERNATIONAL FINANCIAL REPORTING STANDARDS
CONSOLIDATED FINANCIAL STATEMENTS
AND INDEPENDENT AUDITOR'S REPORT
31 DECEMBER 2006

Contents

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INDEPENDENT AUDITOR'S REPORT

To the Shareholders and Board of Directors of open joint-stock company Territorial Generating Company № 1

We have audited the accompanying consolidated financial statements of open joint-stock company Territorial Generating Company № 1 (hereinafter "the Company") and its subsidiaries, which comprise the consolidated balance sheet as of 31 December 2006, consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory notes.

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

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

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

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

Opinion
In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Company as of 31 December 2006, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

INDEPENDENT AUDITOR'S REPORT

Emphasis of matter

Without qualifying our opinion, we draw your attention to Note 3.6 of the accompanying consolidated financial statements. These consolidated financial statements include allocations of revenues and expenses incurred prior to 1 October 2005 by electricity and heat generating divisions within OJSC Lenenergo and OJSC Kolenergo, predecessor legal entities that had other business activities. Because of the various assumptions made in allocating revenues and expenses, as described in Note 3.6 and elsewhere in these consolidated financial statements, those revenues and expenses related to the electricity and heat generation operations within the former structure of the business may not be indicative of revenues expected to be earned and costs expected to be incurred on a prospective basis for the electricity and heat generation operations within the Company as a separate business and, as such, these consolidated financial statements may not be indicative of future results of operations and trends.

08 June 2007

St. Petersburg, Russia

CONSOLIDATED BALANCE SHEET
AS AT 31 DECEMBER 2006
(in thousands of Russian Roubles)

	Notes	31 December 2006	31 December 2005
ASSETS			
Non-current assets			
Property, plant and equipment	6	28 976 074	24 918 996
Investments	7	1 295 030	771 428
Deferred tax assets	8	-	137 915
Other non-current assets	9	105 911	37 288
Total non-current assets		**30 377 015**	**25 865 627**
Current assets			
Cash and cash equivalents	10	650 120	349 629
Accounts receivable and prepayments	11	3 827 650	5 259 868
Inventories	12	1 981 982	1 446 982
Total current assets		**6 459 752**	**7 056 479**
TOTAL ASSETS		**36 836 767**	**32 922 106**
EQUITY AND LIABILITIES			
Equity			
Share capital	13	29 022 225	10 000
Treasury shares	13	(10 000)	-
Merger reserve	13	(6 266 345)	14 083 663
Fair value reserve	7	42 780	22 769
Retained earnings		1 806 127	394 520
Equity attributable to shareholders of OJSC TGC-1		**24 594 787**	**14 510 952**
Minority interest		-	8 752 119
Total equity		**24 594 787**	**23 263 071**
Non-current liabilities			
Deferred tax liabilities	8	1 578 126	968 061
Long-term borrowings	14	1 736 340	957 180
Post-employment benefits	15	501 361	458 797
Total non-current liabilities		**3 815 827**	**2 384 038**
Current liabilities			
Short-term borrowings and current portion of long-term borrowings	16	4 660 227	3 142 365
Accounts payable and accrued liabilities	17	3 487 034	2 843 864
Income tax payable		-	254 069
Other taxes payable	18	278 892	1 034 699
Total current liabilities		**8 426 153**	**7 274 997**
Total liabilities		**12 241 980**	**9 659 035**
TOTAL EQUITY AND LIABILITIES		**36 836 767**	**32 922 106**

Approved on behalf of the Board of Directors on 08 June 2007

General Director Rodin V.N.

Chief Accountant Stanishevskaya R.V.

CONSOLIDATED INCOME STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2006

(in thousands of Russian Roubles)

	Notes	Year ended 31 December 2006	Year ended 31 December 2005
Revenue			
Sales of electricity	19	11 211 738	10 848 501
Sales of heating	19	9 596 888	8 887 489
Other sales	19	785 076	551 576
Total revenue		**21 593 702**	**20 287 566**
Operating expenses	20	(21 803 305)	(18 271 217)
Other operating income	20	927 186	440 636
Impairment loss reversed during the year	6	7 947 024	-
Impairment loss recognised during the year	6	(5 993 876)	-
Total operating costs		**(18 922 971)**	**(17 830 581)**
Operating profit		**2 670 731**	**2 456 985**
Foreign exchange (loss)/gain, net		(12 347)	137 969
Finance cost	22	(382 695)	(42 792)
Profit before income tax		**2 275 689**	**2 552 162**
Income tax charge	8	(718 931)	(855 598)
Profit for the year		**1 556 758**	**1 696 564**
Attributable to:			
Shareholders of OJSC TGC-1		1 561 591	1 092 415
Minority interest		(4 833)	604 149
Earnings per share for profit attributable to the shareholders of OJSC TGC–1 basic and diluted (in Russian Roubles)	**23**	**0.0032**	**1.4139**

CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2006

(in thousands of Russian Roubles)

	Notes	Year ended 31 December 2006	Year ended 31 December 2005
CASH FLOWS FROM OPERATING ACTIVITIES			
Profit before income tax		**2 275 689**	**2 552 162**
Adjustments to reconcile profit before tax and net cash from operating activities:			
Depreciation of property, plant and equipment	6	1 360 695	1 447 050
Impairment loss reversed during the year	6	(7 947 024)	-
Impairment loss recognised during the year	6	5 993 876	-
Provision for impairment of accounts receivable	20	11 908	45 615
Change in financial assets at fair value through profit and loss	7	(475 067)	(188 509)
Finance cost	22	382 695	42 792
Unrealised foreign exchange loss/(gain) on non-operating items		12 348	(137 969)
Gain on disposal of subsidiaries	21	(288 268)	-
Increase in provision for impairment of inventories	12	23 391	-
Loss / (gain) on disposal of property, plant end equipment		28 408	(50 758)
Increase of post-employment benefits		42 564	55 901
Other non-cash items		13 505	(182 604)
Operating cash flows before working capital changes		**1 434 720**	**3 583 680**
Decrease/(increase) in accounts receivable and prepayments		772 042	(4 194 786)
(Increase)/ decrease in inventories		(599 606)	116 962
Increase in accounts payable and accruals		584 323	928 219
Increase in taxes payable other than income tax		90 389	20 963
Cash generated from operations		**2 281 868**	**455 038**
Income tax paid		(655 453)	(61 331)
Interest paid		(338 016)	(18 264)
Net cash generated from operating activities		**1 288 399**	**375 443**
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of property, plant and equipment and other non-current assets		(3 371 993)	(2 443 572)
Proceeds from sales of property, plant and equipment and other non-current assets		55 086	-
Proceeds from disposals of subsidiaries		453 827	-
Interest paid which were capitalised		(96 190)	(87 708)
Net cash used in investing activities		**(2 959 270)**	**(2 531 280)**
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from borrowings		9 896 435	3 741 000
Repayments of borrowings		(7 614 575)	(1 268 694)
Dividends paid		(310 498)	-
Net cash generated from financing activities		**1 971 362**	**2 472 306**
Net increase in cash and cash equivalents		**300 491**	**316 469**
Cash and cash equivalents at the beginning of the year	10	349 629	33 160
Cash and cash equivalents at the end of the year	10	650 120	349 629

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2006

(in thousands of Russian Roubles)

	Equity attributable to shareholders of OJSC TGC-1							
	Share capital	Treasury shares	Merger reserve	Fair value reserve	Retained earnings	**Total**	Minority interest	**Total equity**
At 1 January 2005	**-**	**-**	**13 206 689**	**-**	**-**	**13 206 689**	**9 609 410**	**22 816 099**
Profit for the year	-	-	-	-	1 092 415	**1 092 415**	604 149	**1 696 564**
Issuance of shares	10 000	-	-	-	-	**10 000**	-	**10 000**
Distribution to shareholders	-	-	-	-	(578 732)	**(578 732)**	(602 354)	**(1 181 086)**
Dividends (Note 13)	-	-	-	-	(119 163)	**(119 163)**	-	**(119 163)**
Fair value gain on available-for-sale investments (Note 7)	-	-	-	29 957	-	**29 957**	23 539	**53 496**
Deferred tax on fair value gain	-	-	-	(7 188)	-	**(7 188)**	(5 651)	**(12 839)**
Purchase of minority shares by a predecessor entity	-	-	876 974	-	-	**876 974**	(876 974)	-
At 31 December 2005	**10 000**	**-**	**14 083 663**	**22 769**	**394 520**	**14 510 952**	**8 752 119**	**23 263 071**
Profit for the year	-	-	-	-	1 561 591	**1 561 591**	(4 833)	**1 556 758**
Purchase of treasury shares (Note 13)	-	(10 000)	-	-	-	**(10 000)**	-	**(10 000)**
Dividends (Note 13)	-	-	-	-	(149 984)	**(149 984)**	(100 793)	**(250 777)**
Fair value gain on available-for-sale investments (Note 7)	-	-	-	26 330	-	**26 330**	20 690	**47 020**
Deferred tax on fair value gain	-	-	-	(6 319)	-	**(6 319)**	(4 966)	**(11 285)**
Issuance of shares (Note 13)	29 012 225	-	(20 350 008)	-	-	**8 662 217**	(8 662 217)	-
At 31 December 2006	**29 022 225**	**(10 000)**	**(6 266 345)**	**42 780**	**1 806 127**	**24 594 787**	**-**	**24 594 787**

Note 1. General Information

1.1 The Company and its operations

Open Joint-Stock Company (OJSC) "Territorial Generating Company #1" ("TGC-1", or the "Company") was established on 25 March 2005 within the framework of the Russian electricity sector restructuring in accordance with Resolution No. 181 adopted by the Board of directors of RAO UES of Russia ("RAO UES") on 26 November 2004 and Resolution No. 93p adopted by the Chairman of the Board of Directors of RAO UES of Russia on 18 April 2005. The structure and principles of foundation of TGC-1 were adopted by the Board of Directors of RAO UES of Russia on 23 April 2004 (Resolution # 168).

TGC-1 was founded by three regional energy companies, all controlled by RAO UES: OJSC Lenenergo, OJSC Kolenergo and OJSC Karelenergogeneratsya. Since its foundation TGC-1 is controlled by RAO UES (hereinafter also the "Parent"), and ultimately by the Government of the Russian Federation (see also Note 1.3).

TGC-1 became operational on 1 October 2005 by leasing the generation assets from its founders. On 1 October 2005, Lenenergo span off its generating assets to OJSC Petersburg Generating Company, and Kolenergo span off its generating assets to OJSC Kolskaya Generating Company, OJSC Murmanskaya Thermal Power Plant, and OJSC Apatitskaya Thermal Power Plant. Petersburg Generating Company, Kolskaya Generating Company and Karelenergogeneratsya became the lessors under TGC-1's asset leases.

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

As a result of the generating assets that TGC-1 was leasing, being merged into TGC-1, and the use of the predecessor basis in these consolidated financial statements (see Note 3.2), the consolidated financial statements of TGC-1 have been presented as if it had operated the generating businesses throughout 2005 and 2006. There is no leasing expense or income in these consolidated financial statements.

Currently, TGC-1 operates 55 power plants and its principal activity is electricity and heat generation. TGC-1 electricity capacity as at 31 December 2006 is 6 248.4 MW and heating capacity is 14 735 Gkal/hour.

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

1.2 Operating environment

Whilst there have been improvements in economic trends in the Russian Federation, the country continues to display some characteristics of an emerging market. These characteristics include, but are not limited to, the existence of a currency that is not freely convertible in most countries outside of the Russian Federation 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.

The future economic direction of the Russian Federation is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the Government, together with tax, legal, regulatory, and political developments.

Note 1. General Information (continued)

1.3 Relations with the State and current regulation

As at 31 December 2006, the Russian Federation owned 52.68% of voting shares of RAO UES, which in turn owned 55.60% of voting shares of TGC-1. Therefore, the Russian government is the ultimate controlling party of TGC-1.

Other significant shareholders as at 31 December 2006 were Fortum Power and Heat Oy (25.70%) and HC Interros (7.20%).

The Company's customer base includes a large number of entities controlled by or related to the State of the Russian Federation. Moreover, the State controls a number of the Company's fuel and other suppliers.

The government of the Russian Federation directly affects the Company's operations through regulation by the Federal Service on Tariffs ("FST"), with respect to its wholesale energy sales.

Tariffs which the Company's entities may charge for sales of electricity and heat are governed by regulations specific to the electricity and heat industry and by regulations applicable to natural monopolies. Historically the tariffs have been based on a "prime cost plus markup" system, i.e. the cost of the service provision plus margin, where prime cost is determined in accordance with the Regulations on Accounting and Reporting of the Russian Federation (RAR), a basis of accounting which significantly differs from International Financial Reporting Standards (IFRS). In practice, tariff decisions are impacted significantly by social and political considerations, causing significant delays in tariff decisions being received and tariff increases, which are lower than would otherwise be the case.

As described in Notes 2, 24 and 25, the government's economic, social and other policies could have material effects on the operations of the Company.

1.4 Regulatory issues and sector restructuring

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

A crucial step towards the target wholesale electricity (power) market model was the adoption of the new Wholesale Electricity (Power) Market Rules of the Transitional Period approved by Resolution of the Government of the Russian Federation No. 529 dated 31 August 2006 "On Improvement of the Procedure for Functioning of Wholesale Electricity (Power) Market" which came into force on 1 September 2006. Under the new wholesale market model, the existing electricity and power purchase-and-sale relations in the regulated market sector are to be replaced by a regulated bilateral contract system. From 1 September 2006 regulated contracts cover all volumes of electricity and power produced and consumed.

From 2007 the volumes of electricity (power) traded in the wholesale market at regulated prices will substantially reduce. The pace of reduction will be set annually by the Russian Federation Government according to socio-economic development forecasts. In 2007 up to 95% of the forecasted production volumes will be traded at regulated prices. The period from 2006 to approximately 2013 is a transition period. After that it will become possible to launch a fully competitive wholesale market. The new market model implies two ways of electricity trading at free prices, being free bilateral contracts and a day-ahead market. Under free bilateral contracts market participants have the right to choose contracting parties, prices and supply volumes. The day-ahead market is based on competitive selection of bids submitted by suppliers and buyers a day before the electricity is actually supplied. The competitive selection is performed by the non-commercial partnership "Trade System Administrator of the Wholesale Electricity Market". If there are deviations from the day-ahead forecast, participants are obliged to sell excess amounts or buy missing amounts in the balancing market. As a whole, the day-ahead market replaces the free trade sector that was previously operating. Consumption and production planning held by the System operator CDU UES is based on the results of bidding.

Management believes that ultimately a stable regulatory regime and a competitive power market will be established so that the Company will be able to sustain the business. However, there can be no assurance in this regard.

Note 2. Financial Condition and Going Concern

At 31 December 2006, the Company's current liabilities exceeded its current assets by RR 1 966 401 thousand (at 31 December 2005: RR 218 518 thousand). As at 31 December 2006 and at 31 December 2005 the Company's net assets were positive (RR 24 594 787 thousand and RR 23 263 071 thousand, respectively).

The Company is affected by Government policy through control of tariffs and other factors. The FST does not always permit tariff increases in excess of the increases in the Company's costs and thus some tariffs are insufficient to cover all the costs of generation. Moreover, these tariffs consider costs only on a Russian statutory basis and, accordingly, exclude additional costs recognised under an IFRS basis of accounting.

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

- negotiations with federal and regional authorities and regulators to address the issue of the real increase in tariffs to support adequate long-term investments into the Company's generating assets;
- refinancing of current liabilities and short-term borrowings;
- capital raising in debt and equity markets.

The Company's management believes that these continuing efforts will result in improvements in the Company's profitability and liquidity, and the Company will be able to raise the needed capital to sustain the business.

Accordingly, these consolidated financial statements have been prepared on a going concern basis, which contemplates the realisation of assets and the settlement of liabilities in the normal course of business, and do not include any adjustments should the Company be unable to continue as a going concern.

Note 3. Basis of Preparation

3.1 Statement of compliance

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) under the historical cost convention as modified by available-for-sale investments and financial assets at fair value through profit or loss. The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated.

The Company 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. These consolidated financial statements are based on the statutory records and adjusted and reclassified for the purpose of fair presentation in accordance with IFRS.

These are the first consolidated IFRS financial statements of the Company. The Company has applied IFRS for the first time as at 1 January 2005. The Company did not previously prepare Russian GAAP consolidated financial statements as a separate reporting entity and accordingly no meaningful reconciliations from Russian GAAP to IFRS can be provided.

3.2 Predecessor Accounting

As disclosed in Note 1, in November 2006, the Parent transferred to the Company the outstanding ordinary shares of OJSC Apatitskaya Thermal Power Plant (49.27%), OJSC Karelenergogeneratsya (100%), OJSC Kolskaya Generating Company (49.27%) and OJSC Petersburg Generating Company (56.01%). As disclosed in Note 13.1 this was done by converting all shares of these entities into ordinary shares of TGC-1. As a result, RAO UES shareholdings (49.27% of OJSC Apatitskaya Thermal Power Plant, 100% of OJSC Karelenergogeneratsya, 49.27% of OJSC Kolskaya Generating Company and 56.01% of OJSC Petersburg Generating Company) and minorities' shareholdings (50.73% of OJSC Apatitskaya Thermal Power Plant, 50.73% of OJSC Kolskaya Generating Company and 43.99% of OJSC Petersburg Generating Company) were exchanged for the shares of TGC-1.

In these consolidated financial statements, the Company accounted for this business combination amongst entities under common control using the pooling of interests method. Accordingly, assets and liabilities of the transferred entities were initially accounted for at the carrying values as determined by the Parent in its IFRS consolidated financial statements as at 31 December 2004. Information in respect of 2005 is presented as if the business combination took place as at 1 January 2005.

Note 3. Basis of Preparation (continued)

Therefore, OJSC Apatitskaya Thermal Power Plant, OJSC Karelenergogeneratsya, OJSC Kolskaya Generating Company and OJSC Petersburg Generating Company were consolidated into the Company's consolidated financial statements starting from 1 January 2005.

Before their formation on 1 October 2005, OJSC Apatitskaya Thermal Power Plant, OJSC Kolskaya Generating Company and OJSC Petersburg Generating Company operated as branches of OJSC Kolenergo and OJSC Lenenergo, comprising their generating assets. In these consolidated financial statements, the financial information relating to the generating activities of the above entities for the 9 months ended 30 September 2005 was carved out from the respective financial statements of OJSC Kolenergo and OJSC Lenenergo. Significant judgements and estimates made by management for the purposes of this carve-out are disclosed in Note 3.6.

OJSC Karelenergogeneratsya was founded on 1 January 2005.

3.3 Functional and presentation currency

The national currency of the Russian Federation is the Russian Rouble ("RR"), which is the functional currency of the Company and the currency in which these consolidated financial statements are presented. All financial information presented in RR has been rounded to the nearest thousand.

3.4 Inflation accounting

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

3.5 New accounting developments

During the period December 2003 to May 2007, the International Accounting Standards Board ("IASB") made 27 revisions to its standards and issued eight new standards. In addition, the International Financial Reporting Interpretations Committee ("IFRIC") issued ten new interpretations, one of which was subsequently withdrawn. Certain new IFRSs are effective for accounting periods commencing on or after 1 January 2005, except for IFRS 6 "Exploration and Evaluation of Mineral Resources" and IFRS 7 "Financial instruments: disclosures", 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 Company adopted all of those IFRS, which are relevant to its operations and are in force as at 31 December 2006.

The following new Standards and Interpretations are not yet effective and have not been applied in preparing these consolidated 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 about the Company's financial instruments.
- IFRS 8, Operating Segments (effective for annual periods beginning on or after 1 January 2009). The standard applies to entities whose debt or equity instruments are traded in a public market or that file, or are in the process of filing, their financial statements with a regulatory organization for the purpose of issuing any class of instruments in a public market. IFRS 8 requires an entity to report financial and descriptive information about its operating segments and specifies how an entity should report such information. Management is currently assessing what impact the Standard will have on segment disclosures in the TGC-1 consolidated financial statements.
- 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 Company's capital.

Note 3. Basis of Preparation (continued)

- IAS 23, Borrowing Costs (effective for annual periods beginning on or after 1 January 2009). The revised IAS 23 was issued in March 2007. The main change to IAS 23 is the removal of the option of immediately recognising as an expense borrowing costs that relate to assets that take a substantial period of time to get ready for use or sale. An entity is, therefore, required to capitalise such borrowing costs as part of the cost of the asset. The revised Standard applies prospectively to borrowing costs relating to qualifying assets for which the commencement date for capitalisation is on or after 1 January 2009. The Company is currently assessing the impact of the amended Standard.

- IFRIC 7 "Applying the Restatement Approach under IAS 29", which is effective for periods beginning on or after 1 March 2006. 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. 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 June 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 periods beginning on or after 1 November 2006. The interpretation clarifies that an entity should not reverse an impairment loss recognised in the previous interim periods in respect of goodwill or an investment in a financial asset carried at cost.

- IFRIC 11 "Group and Treasury Shares Transactions" which is effective for periods beginning on or after 1 March 2007. This Interpretation addresses how to apply IFRS 2 "Share-based Payment" to share-based payment arrangements involving an entity's own equity instruments or equity instruments of another entity in the same group (e.g. equity instruments of its parent).

- IFRIC 12 "Service Concession Arrangements", which is effective for annual periods beginning on or after 1 January 2008.

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

3.6 Critical accounting estimates and assumptions

The Company makes estimates and assumptions that affect the reported amounts of assets and liabilities. 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:

Transaction under common control and carve-out principles

The Parent retained the controlling interest in the generating businesses of TGC-1 predecessors after their restructuring, legal incorporation and merger of TGC-1 (see also Note 3.2), therefore restructuring and subsequent merger is a transaction among the entities under common control. As a result, the Company accounted for the merger of TGC-1, Petersburg Generating Company, Kolskaya Generating Company, Apatytskaya Thermal Power Plant and Karelenergogeneratsya using the predecessor basis of accounting, whereby the assets and liabilities of the generating businesses have been accounted for at the IFRS historical carrying values of RAO UES. Under the predecessor basis of accounting the Company has also presented the generating business as a separate business for the current period and corresponding period as if this business had always been a separate company.

Note 3. Basis of Preparation (continued)

These consolidated financial statements include allocations of assets and liabilities, revenues and expenses incurred prior to 1 October 2005 by electricity and heat generating divisions within Lenenergo and Kolenergo, predecessor legal entities of TGC-1 that had other business activities.

The following significant assumptions were made by management in allocating assets and liabilities, revenues and expenses to generating businesses:

- Revenue from heat and electricity generation was calculated by applying the tariffs for generation established by the Regional Services on Tariffs (“RST”) for Lenenergo and Kolenergo for the 9 months ended 30 September 2005, to the actual volume of heat and power generated by these entities during that period;
- Direct operating expenses and production overheads, such as direct labour, fuel, repairs and maintenance, depreciation, were recorded on actual basis as incurred by respective power stations for the 9 months ended 30 September 2005. Only those overheads that were attributed to assets and liabilities belonging to generation were accounted for (property tax, environmental tax, interest expense on borrowings drawn down by generating divisions or to finance construction of generating assets). General and corporate overheads, such as costs of central accounting department and General director, consulting and legal services, IT, were not allocated to the generating business;
- Current income tax charge was calculated on the basis of the effective income tax rate for the 9 months ended 30 September 2005 for Lenenergo and Kolenergo, applied to profits before tax carved-out following principles for revenue and expenses as above;
- Income tax payable and other taxes payable were not recognised on the balance sheet as all tax liabilities were transferred upon restructuring to grid companies, legal successors of Lenenergo and Kolenergo, and were subsequently paid by them;
- Property, plant and equipment, including provision for impairment, were recorded as determined by the Parent in its IFRS consolidated financial statements;
- Other assets and liabilities, including cash, inventory, accounts receivable and accounts payable, borrowings were recorded on actual basis from accounting ledgers maintained by generating divisions and attributable to generating businesses only;
- Deferred tax liability was calculated using the balance sheet method on the basis of carved-out balance sheets for the generating business.

Because of the various assumptions made in allocating revenues and expenses, those revenues and expenses related to the electricity and heat generation operations within the former structure of the business may not be indicative of revenues expected to be earned and costs expected to be incurred on a prospective basis for the electricity and heat generation operations within the Company as a separate business and, as such, these financial statements may not be indicative of future results of operations and trends.

Provision for impairment of property, plant and equipment

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

Management considered recent favorable changes in operation of the Russian electricity market (see also Note 1.4) and reassessed recoverable amount of the Company’s property, plant and equipment as at 31 December 2006. As a result, management believes that provision for impairment of property, plant and equipment recorded by the Company as at 1 January 2005 and 31 December 2005 in respect of electricity and heat generating assets using the predecessor accounting basis of the Parent should be partially reversed as at 31 December 2006. The amount of reversal is estimated by management as RR 7 947 024 thousand. On the other hand, management considered further obsolescence of the heating network and TPP of Nevsky Branch and recognised further impairment loss in respect of the property, plant and equipment of these cash generating units in the amount of RR 5 993 876 thousand (see also Note 6).

(in thousands of Russian Roubles)

Note 3. Basis of Preparation (continued)

Management applied the following significant assumptions when estimating value in use of the property, plant and equipment as at 31 December 2006 and determining the levels of impairment provisions as at 31 December 2006:

- increase in electricity tariffs set for the Company for 2007 was on average 26%; further expected increase in tariffs is estimated by the management as 13%-20% p.a. in 2008-2011 and 3%-4% p.a. in 2012 and onwards;
- increase in heat tariffs set for the Company for 2007 were on average 15%; further expected increase in tariffs is estimated by the management as 10%-16% p.a. in 2008-2011; 5%-7% p.a. in 2012-2013 and 3%-4% p.a. in 2014 and onwards;
- growth of gas prices set in the Government's forecast is not expected to exceed the limit of 15% in 2007, which does not significantly exceed the expected inflation;
- growth of coal prices set in the Government's forecast is not expected to exceed the limit of 8.9% in 2007;
- increase of mazut prices set by the financial plan approved by the Board of Directors of TGC-1 on the level of 19% for 2007;
- average expected increase in fuel prices was estimated by the management on average as 8% p.a. (for coal for Apatitskaya TPP) and 19% p.a. (for all other TPPs) in 2008-2010 and 3% p.a. for both coal and gas TPPs in 2011 and onwards;
- the assumption was made that production volumes of electricity and heat will remain at the current level for the whole impairment test period (investment programme is not included);
- for the cash generating unit Heating Network of Nevsky Branch increase in tariffs for heat transportation was estimated in proportion to the heat tariffs increase;
- repair and maintenance expenses of cash generating unit Heating Network of Nevsky Branch on the basis of repair cost of 1 km of pipelines (RR 49 890 thousand for 2007) applied to 40 km of heating networks requiring repairs on annual basis. Total length of heat pipelines for Heating network of Nevsky branch is approximately 800 km;
- weighted average cost of capital of 12.02 % was applied for discounting future operating cash flows generated by the Company for all cash generating units;
- average remaining useful lives are estimated by the management for separate cash generating units as follows:

Name of cash generating unit	Average remaining useful lives, years
Hydro-electric power stations (HPS) of Kolsky branch	24
Karelsky branch	40
Apatitskaya Thermal Power Plant (TPP)	54
HPS of Nevsky branch	6
TPP of Nevsky branch	17
Heating network of Nevsky branch	11

- the Company'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 generating businesses.

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 particular:

- Should the tariffs for electricity and heat be further increased/ decreased by 10% p.a. then an estimate of the recoverable amount would result in a decrease/increase in impairment provision of RR (9 681 262)/ 11 359 537 thousand as at 31 December 2006.
- Should the operating expenses of the Company be further increased/ decreased by 10% p.a. then an estimate of the recoverable amount would result in an increase/decrease in impairment provision of RR 10 506 380/ (10 175 425) thousand as at 31 December 2006.

Note 3. Basis of Preparation (continued)

- Should the remaining useful economic lives of property, plant and equipment be further increased/decreased by 10%, then an estimate of the recoverable amount would result in a decrease/increase in impairment provision of RR (1 289 107)/ 1 461 681 thousand as at 31 December 2006.
- Should the weighted average cost of capital be increased/decreased by 10%, then an estimate of the recoverable amount would result in a increase/decrease in impairment provision of RR 1 237 592/ (1 275 946) thousand as at 31 December 2006.

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

Estimated fair value of available- for-sale investment

Management has estimated the fair value of a 3.0685% equity interest in the OJSC North West Thermal Power Plant ("NWTPP") for the purposes of these financial statements using the market approach. The market approach involved information about the most recent arm's length transactions with shares in NWTPP between knowledgeable willing parties, in particular, purchase of 25% plus one share in NWTPP by InterRAO from Vneshtorgbank in July 2005 for a cash consideration of RR 2 710 570 thousand or RR 650 per share, which was then adjusted for a minority interest discount factor of 10% to arrive at an estimate of the fair value of 3.0685% investment in NWTPP as at 1 January 2005.

As at 31 December 2005 InterRAO had the intention to sell its shares in NWTPP, and the starting price for the share auction announced in May 2006 of RR 766 per share after application of a minority interest discount of 10% was used by management to arrive at an estimate of the fair value of 3.0685% investment in the North West Thermal Power Plant as at 31 December 2005.

In the absence of further arm's length transactions for the shares in NWTPP in 2006 and 2007, management applied the average market multiple for TGC and OGC of US$ 550 per kW to the installed capacity of NWTPP of 900 MW as at 31 December 2006 to estimate the fair value of its 3.0685% investment in NWTPP as at 31 December 2006.

Should the minority discount factor be increased/decreased by 10% then an estimate of the fair value of a 3.0685% equity interest in NWTPP would result in a decrease/increase of RR 3 327 thousand as at 1 January 2005 and a decrease/increase of RR 3 922 thousand as at 31 December 2005.

Should the market multiple for TGC and OGC be increased/decreased by 10% then an estimate of a 3.0685% equity interest in NWTPP would result in an increase/decrease of RR 39 995 thousand as at 31 December 2006.

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.

Were the estimated useful lives to differ by 10% from management's estimates, the impact on depreciation for the year would be to increase it by RR 145 838 thousand or decrease it by RR 122 628 thousand (Note 6).

Provision for impairment of accounts receivable

Provision for impairment of accounts receivable is based on the Company's assessment of whether the collectibility of specific customer accounts worsened compared to previous period estimates. If there is a deterioration in a major customer's creditworthiness or actual defaults are higher than the estimates, the actual results could differ from these estimates (see also Note 11).

Tax legislation

Russian tax, currency and customs legislation is subject to varying interpretations (Note 25).

(in thousands of Russian Roubles)

Note 3. Basis of Preparation (continued)

Pension obligation

The principal actuarial assumptions used to calculate the defined benefit obligation as at 31 December 2006 and 31 December 2005, are listed in Note 15. The impact of potential changes in these assumptions is as follows:

	Change in present value of the defined benefit obligation as at 31 December 2006 and 31 December 2005
Discount rate lower by 0.75 % p.a.	8%
Salary rate increase of 0.75% p.a.	1%
Inflation (pension rate) increase of 0.75% p.a.	7%
Withdrawal rate lower by 1.5% p.a.	7%

Note 4. Summary of Significant Accounting Policies

4.1 Principles of consolidation

The consolidated financial statements comprise the financial statements of the Company and the financial statements of those entities whose operations are controlled by the Company. Control is presumed to exist when the Company has the right to control entities directly or indirectly through subsidiaries.

Subsidiaries. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control effectively commences until the date that control effectively ceases. The minority interest has been disclosed as part of equity.

Transactions eliminated on consolidation. Intercompany balances and transactions, and any unrealised gains arising from intercompany transactions, are eliminated in preparing the consolidated financial statements.

4.2 Transfers of subsidiaries from parties under common control

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

4.3 Foreign currency

Monetary assets and liabilities, which are held by the Company 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 income statement.

As at 31 December 2006, 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 26.3311: USD 1 (31 December 2005 - RR 28.7825: USD 1), between the RR and EURO RR 34.6965: EUR 1 (31 December 2005 - RR 34.1850: EUR 1).

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

4.4 Property, plant and equipment

Property, plant and equipment are stated at cost, restated to the equivalent purchasing power of the Russian Rouble at 31 December 2002 for assets acquired prior to 1 January 2003 (see Note 3.4), less accumulated depreciation and provision for impairment, where required. Cost includes borrowing costs incurred on specific or general funds borrowed to finance construction of qualifying assets.

In 2005 property, plant and equipment were recorded at the carrying values determined in accordance with the IFRS at the date of their transfer to the Company by the Predecessor (the Parent).

(in thousands of Russian Roubles)

Note 4. Summary of Significant Accounting Policies (continued)

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

Costs of minor repairs and maintenance are expensed when incurred. Renewals and improvements are capitalised and the assets replaced are retired. Gains and losses arising from the retirement of property, plant and equipment are included in the income statement as incurred.

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

Depreciation of property, plant and equipment is calculated on a straight-line basis over the estimated useful life of the asset when it is available for use.

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
Production buildings	21-32	50
Hydrotechnical buildings	35-44	50
Generating equipment	11-31	20-30
Heating networks	13-17	20
Other	5-23	10-25

4.5 Cash and cash equivalents

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

4.6 Inventories

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

4.7 Value added tax on purchases and sales

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

4.8 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 receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest rate method less provision for impairment. Such a provision for impairment of accounts receivable is established if there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of the receivables. The amount of the provision is the difference between the carrying amount and the recoverable amount, being the present value of expected cash flows, discounted at the market rate of interest for similar borrowers at the date of origination of the receivables.

4. Summary of Significant Accounting Policies (continued)

Differences in tariffs for sale of electricity through FOREM for individual sellers and tariffs for purchasers of electricity from FOREM for individual customers resulted in wholesale electricity market imbalances (WEM Note

imbalance) on FOREM being written off the balance sheet. The revenues recognised in relation with the WEM imbalance are reversed from the income statement.

4.9 Classification, recognition and measurement of financial assets

The Company classifies its financial assets into the following measurement categories: financial assets at fair value through profit or loss, available-for-sale, held to maturity and loans and receivables.

Financial assets at fair value through profit or loss are securities or other financial assets, which are either acquired for generating a profit from short-term fluctuations in price or trader's margin, or are included in a portfolio in which a pattern of short-term trading exists. Management determines classification of financial assets at fair value through profit or loss upon their initial recognition. Financial assets at fair value through profit or loss are carried at fair value. Changes in fair values of these financial assets are recorded in income statement. Dividends are included in dividend income within other operating income when the Company's right to receive the dividend payment is established.

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

Held to maturity classification includes quoted non-derivative financial assets with fixed or determinable payments and fixed maturities that the Company has both the intention and ability to hold to maturity. Management determines the classification of investment securities held to maturity at their initial recognition and reassesses the appropriateness of that classification at each balance sheet date. Held to maturity investments are carried at amortised costs using the effective interest method, net of a provision for incurred impairment losses.

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

4.10 Accounts payable and accrued liabilities

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

4.11 Borrowings

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

4.12 Minority interest

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

4.13 Provisions for liabilities and charges

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

Note 4. Summary of Significant Accounting Policies (continued)

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

4.14 Pension and post-employment benefits

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

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

The liability recognised in the balance sheet in respect of the defined benefit pension plans is the present value of the defined benefit obligations at the balance sheet date less the fair value of plan assets.

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

The defined benefit obligations are calculated using the projected unit credit method. The present value of the defined benefit obligations is determined by discounting the estimated future cash outflows using interest rates of government bonds that are denominated in the currency in which the benefits associated with the operations of the plan will be paid, and that have terms to maturity approximating the terms of the related post-employment benefits.

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

4.15 Income tax

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

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

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

4.16 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.

4.17 Operating lease

Where the Company is a lessee in a lease which does not transfer substantially all the risks and rewards incidental to ownership from the lessor to the Company, the total lease payments are charged to profit or loss on a straight-line basis over the period of the lease.

Note 4. Summary of Significant Accounting Policies (continued)

4.18 Equity

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

Merger reserve. The difference between the the carrying value of the net assets merged into the Company as a result of the transaction under common control and the minority interest is recorded in equity, as a merger reserve.

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

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

4.19 Environmental expenses

Current environmental expenses are recorded when incurred.

4.20 Earnings per share

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

4.21 Segment reporting

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

4.22 Seasonality

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

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

4.23 Interest

Interest income and expense are recognised in the income statement for all interest bearing instruments on an accrual basis using the effective interest rate method. Interest income includes nominal interest and accrued discount and premium. When loans become doubtful for collection, they are written down to their recoverable amounts and interest income is thereafter recognised based on the rate of interest that was used to discount the future cash flows for the purpose of measuring the recoverable amount.

(in thousands of Russian Roubles)

Note 5. Related Parties

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

Related parties include shareholders, directors, subsidiaries and associates as well as companies that are the ownership of or controlled by the same companies as TGC-1. RAO UES is the main shareholder of the TGC-1 and has a substantial control over the Company's activity.

The nature of the related party relationships for those related parties with whom the Company entered into significant transactions in the years ended 31 December 2006 and 31 December 2005, and had significant balances outstanding at 31 December 2006 and at 31 December 2005 are detailed below.

5.1 RAO UES

As at 31 December 2006 and 31 December 2005 the Company had a liability to RAO UES, for dividends accrued but not paid in the amount of RR 37 049 thousand and RR 119 164 thousand, respectively.

5.2 Transactions with RAO UES subsidiaries

Transactions with the Parent's subsidiaries were as follows:

	Year ended 31 December 2006	Year ended 31 December 2005
Sales of electricity	8 698 700	10 634 319
Other sales	56 286	20 811
Total sales	**8 754 986**	**10 655 130**

Balances with the Parent's subsidiaries at the end of the period were as follows:

	31 December 2006	31 December 2005
Accounts receivable and prepayments	141 457	1 308 000
Accounts payable and accrued liabilities	140 676	192 189

As at 31 December 2006 the Company also issued guarantees in respect of the borrowings drawn down by the Parent's subsidiaries in the amount of RR 480 550 thousand (31 December 2005: none).

5.3 State-controlled entities

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

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

	Year ended 31 December 2006	Year ended 31 December 2005
Sales of heating	9 132 615	8 424 552
Fuel	7 754 223	6 220 416
Water usage expenses	1 540 715	1 351 909
Electricity purchases	1 048 512	304 375
Heat distribution	919 514	853 213
Sales of electricity	470 799	11
Heat purchases	161 552	149 605
Interest expense	62 860	9 836
Railway transportation	6 091	9 811

(in thousands of Russian Roubles)

Note 5. Related Parties (continued)

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

	31 December 2006	31 December 2005
Accounts receivable and prepayments	1 713 937	1 446 104
Borrowings	1 015 000	1 256 000
Accounts payable and accrued liabilities	396 117	675 818
Cash	41 368	121 359
Interest expense	2 411	1 174

5.4 Other transactions with related parties

The Company had the following significant transactions with the shareholder Fortum Power and Heat Oy:

	31 December 2006	31 December 2005
Sales of electricity	326 744	214 149
Accounts receivable and prepayments	37 621	-
Accounts payable and accrued liabilities	3 601	-

As at 22 December 2006, a long-term loan of RR 1 040 895 thousand was received from Nordic Investment Bank (affiliated to the Company's shareholder Fortum Power and Heat Oy). For detailed information about long-term borrowings, please see Note 14.

5.5 Transactions with the Board of Directors and key management personnel

Total remuneration in the form of salary and bonuses paid to the members of the Board of Directors and key management personnel for the year ended 31 December 2006 was RR 70 257 thousand (2005: RR 7 628 thousand). All remuneration falls under short-term employee benefits definition in IAS 19 "Employee Benefits".

(in thousands of Russian Roubles)

Note 6. Property, Plant and Equipment

Cost	**Production buildings**	**Hydrotechnical buildings**	**Generating equipment**	**Heating networks**	**Construction in progress**	**Other**	**Total**
Balance as at 31 December 2005	13 262 491	16 403 925	9 277 701	19 887 569	7 689 640	10 695 446	77 216 772
Additions	8 377	-	4 613	120	3 567 983	87 533	3 668 626
Transfers	1 001 326	21 509	1 871 052	1 694 592	(7 968 924)	3 380 445	-
Disposals	(190 980)	-	(8 237)	(23 424)	(92 357)	(376 593)	(691 591)
Balance as at 31 December 2006	**14 081 214**	**16 425 434**	**11 145 129**	**21 558 857**	**3 196 342**	**13 786 831**	**80 193 807**
Accumulated depreciation (including impairment)							
Balance as at 31 December 2005	(9 381 845)	(10 275 153)	(7 816 359)	(16 104 062)	-	(8 720 357)	(52 297 776)
Charge for the year	(180 816)	(183 646)	(196 677)	(457 481)	-	(342 075)	(1 360 695)
Disposals	159 514	-	2 556	20 391	-	305 129	487 590
Impairment losses reversed/ (recognised) during the year (Note 3.6)	1 688 747	2 153 910	1 131 585	(3 111 315)	-	90 221	1 953 148
Balance as at 31 December 2006	**(7 714 400)**	**(8 304 889)**	**(6 878 895)**	**(19 652 467)**	**-**	**(8 667 082)**	**(51 217 733)**
Net book value as at 31 December 2005	3 880 646	6 128 772	1 461 342	3 783 507	7 689 640	1 975 089	24 918 996
Net book value as at 31 December 2006	**6 366 814**	**8 120 545**	**4 266 234**	**1 906 390**	**3 196 342**	**5 119 749**	**28 976 074**

Cost	**Production buildings**	**Hydrotechnical buildings**	**Generating equipment**	**Heating networks**	**Construction in progress**	**Other**	**Total**
Balance as at 01 January 2005	13 243 397	16 371 187	9 081 496	19 481 387	6 389 649	10 435 407	75 002 523
Additions	1 187	-	3 553	30 768	2 480 612	107 470	2 623 590
Transfers	37 570	32 738	194 744	523 743	(1 180 463)	391 668	-
Disposals	(19 663)	-	(2 092)	(148 329	(158)	(239 099)	(409 341)
Balance as at 31 December 2005	**13 262 491**	**16 403 925**	**9 277 701**	**19 887 569**	**7 689 640**	**10 695 446**	**77 216 772**
Accumulated depreciation (including impairment)							
Balance as at 01 January 2005	(9 217 939)	(10 085 146)	(7 645 643)	(15 929 223)	-	(8 416 465)	(51 294 416)
Charge for the year	(175 374)	(190 007)	(172 822)	(392 670)	-	(516 177)	(1 447 050)
Disposals	11 468	-	2 106	217 831	-	212 285	443 690
Balance as at 31 December 2005	**(9 381 845)**	**(10 275 153)**	**(7 816 359)**	**(16 104 062)**	**-**	**(8 720 357)**	**(52 297 776)**
Net book value as at 01 January 2005	4 025 458	6 286 041	1 435 853	3 552 164	6 389 649	2 018 942	23 708 107
Net book value as at 31 December 2005	**3 880 646**	**6 128 772**	**1 461 342**	**3 783 507**	**7 689 640**	**1 975 089**	**24 918 996**

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

Interest expense is capitalised if it is directly concerned with project construction. The amount of borrowing costs capitalised during a period did not exceed the amount of borrowing costs incurred during that period.

(in thousands of Russian Roubles)

Note 6. Property, Plant and Equipment (continued)

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

Property, plant and equipment balances as at 31 December 2006 included RR 573 941 thousand of assets which were pledged as collateral according to loan agreements (at 31 December 2005: RR 472 483 thousand) (see Note 14).

Impairment. Management assessed the recoverability of property, plant and equipment as at 31 December 2006. Value in use has been estimated through a review of discounted future cash flows for six cash-generating units. The significant assumptions applied by management in this impairment assessment are disclosed in Note 3.6. Based on this assessment the previously recognised impairment loss in respect of electricity and heat generation assets of RR 7 947 024 thousand was released, while further impairment loss of RR 5 993 876 thousand was recognised in respect of heating networks and TPP of Nevsky Branch.

Operating lease

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

	31 December 2006	31 December 2005
Not later than one year	42 984	35 354
Later than one year and not later than five years	171 936	130 662
Later than five years	1 149 315	967 450
Total	**1 364 235**	**1 133 466**

Note 7. Investments

	% ownership	31 December 2006	31 December 2005
Held at fair value through profit or loss:			
Equity shares in OJSC Power Machines	2.5723%	890 232	415 165
Available-for-sale investments:			
Equity shares in NWTPP	3.0685%	399 948	352 926
Other		4 850	3 337
Total investments		**1 295 030**	**771 428**

Upon initial recognition the investment in OJSC Power Machines, entity under significant influence of the Parent, was designated by the Company as financial asset “at fair value through profit or loss”. Management has estimated the fair value of the 2.5723% equity interest in the OJSC Power Machines for the purposes of these consolidated financial statements using the quoted marked price calculated based on Russian Trading System (RTS, stock exchange) quotes. Income from remeasurement of this investment to its fair value recognised for the year ended 31 December 2006 and disclosed in the line “Change in financial assets at fair value through profit or loss” amounted to RR 475 067 thousand (year ended 31 December 2005: RR 188 509 thousand).

Available-for-sale investments include shares in NWTPP, entity controlled by the Parent, which are not publicly traded. Management estimated fair value of these shares as at each reporting date using market approach (see Note 3.6). Income from remeasurement of this investment to its fair value is recognised directly in equity, in Fair value reserve, and amounted to RR 47 020 thousand for the year ended 31 December 2006 (year ended 31 December 2005: RR 53 496 thousand).

(in thousands of Russian Roubles)

Note 8. Income Tax

	Year ended 31 December 2006	Year ended 31 December 2005
Current income tax charge	18 127	697 557
Deferred income tax charge	700 804	158 041
Income tax charge	**718 931**	**855 598**

In 2006 and 2005 the Company was subject to a 24% income tax rate on taxable profits.

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

	Year ended 31 December 2006	Year ended 31 December 2005
Profit before tax	**2 275 689**	**2 552 162**
Theoretical tax charge at the statutory tax rate of 24%	546 165	612 519
Tax effects of items which are non-deductible for income tax purposes	172 766	243 079
Income tax charge	**718 931**	**855 598**

Deferred tax assets and liabilities

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

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

As at 31 December 2005, deferred tax assets and liabilities related to different entities within TGC-1, therefore the assets and liabilities were offset within these different entities by the total amount of RR 91 851 thousand, resulting in net liabilities of RR 968 061 thousand and net assets of RR 137 915 thousand; as at 31 December 2006, deferred tax assets and liabilities were offset within TGC-1 as a single entity by the total amount of RR 355 662 thousand, resulting in a net liability of RR 1 578 126 thousand.

	31 December 2005	(Charged)/ credited to income statement	Charged to equity	Disposal of subsidiaries	31 December 2006
Deferred tax assets/(liabilities):					
Property, plant and equipment	(943 490)	(687 815)	-	(37 498)	(1 668 803)
Investments	(62 914)	(113 131)	(11 285)	-	(187 330)
Accounts receivable	24 911	(102 475)	-	-	(77 564)
Accounts payable and accrued liabilities	131 058	6 416	-	-	137 474
Tax loss carried forward	-	183 419	-	-	183 419
Other	20 289	12 782	-	1 607	34 678
Net deferred tax liability	**(830 146)**	**(700 804)**	**(11 285)**	**(35 891)**	**(1 578 126)**

(in thousands of Russian Roubles)

Note 8. Income Tax (continued)

	31 December 2004	(Charged)/credited to income statement	Charged to equity	31 December 2005
Deferred tax assets/(liabilities):				
Property, plant and equipment	(770 949)	(172 541)	-	(943 490)
Investments	-	(50 075)	(12 839)	(62 914)
Accounts receivable	7 963	16 948	-	24 911
Accounts payable and accrued liabilities	96 695	34 363	-	131 058
Other	7 025	13 264	-	20 289
Net deferred tax liability	**(659 266)**	**(158 041)**	**(12 839)**	**(830 146)**

Note 9. Other Non-Current Assets

	31 December 2006	31 December 2005
Long-term receivables (interest free)	56 586	123
Loans issued (at 8.5% interest rate)	32 668	30 109
Input VAT to be recovered in more than one year after reporting date	11 223	7 056
Other non-current assets	5 434	-
Total	**105 911**	**37 288**

As at 31 December 2006 and 31 December 2005 long-term receivables and loans issued are recorded at amortised cost. Loss on discounting of long-term receivables is included in Finance cost (Note 22). The amount of the discount as at 31 December 2006 is RR 12 605 thousand (31 December 2005: RR 15 164 thousand).

Note 10. Cash and Cash Equivalents

	31 December 2006	31 December 2005
Cash in bank and in hand in RR (effective interest rate: 0%)	516 367	323 759
Foreign currency accounts (primarily USD)	127 582	-
Cash equivalents	6 171	25 870
Total	**650 120**	**349 629**

Note 11. Accounts Receivable and Prepayments

	31 December 2006	31 December 2005
Trade receivables, net of provision for impairment of RR 49 326 thousand (31 December 2005: RR 54 404 thousand)	1 815 960	3 574 257
Value added tax receivable	973 855	1 308 659
Advances to suppliers (net of provision for impairment of RR 5 223 thousand as at 31 December 2005)	67 407	61 585
Other taxes receivable	564 396	26 384
Other receivables, net of provision for impairment of RR 30 400 thousand (31 December 2005: RR 19 315 thousand)	406 032	288 983
Total	**3 827 650**	**5 259 868**

Note 12. Inventories

	31 December 2006	31 December 2005
Fuel supplies	1 237 958	644 755
Spare parts	401 710	389 910
Raw materials and other supplies	342 314	412 317
Total	**1 981 982**	**1 446 982**

Raw materials and other supplies are recorded net of provision for impairment in the amount of RR 27 114 thousand as at 31 December 2006 (31 December 2005: RR 3 723 thousand).

Inventories balances as at 31 December 2005 included RR 117 860 thousand of inventories which were pledged as collateral under loan agreements (see Note 14).

Note 13. Equity

13.1 Share capital

	31 December 2006	31 December 2005
Number of ordinary shares authorised, issued and fully paid (in thousands)	2 902 222 495	1 000 000
Nominal value (in RR)	0.01	0.01

Share capital of the Company was formed as follows:

- Cash contributions of RR 10 000 thousand paid in 2005 for the shares in TGC-1 by the founders of TGC-1, namely OJSC Lenenergo (630 000 thousand shares with nominal value of 0.01 RR), OJSC Karelenergogeneratsiya (120 000 thousand shares with nominal value of 0.01 RR) and OJSC Kolenergo (250 000 thousand shares with nominal value of 0.01 RR). Shares held by Lenenergo and Kolenergo were subsequently transferred to their successors OJSC Petersburg Generating Company and OJSC Kolskaya Generating Company. On 1 November 2006, after the merger of OJSC Petersburg Generating Company, OJSC Kolskaya Generating Company, OJSC Apatitskaya Thermal Power Plant and OJSC Karelenergogeneratsiya into TGC-1 (see also Note 1.1) these shares were classified as treasury shares;
- As of 1 November 2006 the Company increased its share capital by RR 29 012 225 thousand by converting ordinary shares of OJSC Apatitskaya Thermal Power Plant, OJSC Karelenergogeneratsya, OJSC Kolskaya Generating Company and OJSC Petersburg Generating Company into ordinary shares of TGC-1. As a result, RAO UES shareholdings (49.27% of OJSC Apatitskaya Thermal Power Plant, 100% of OJSC Karelenergogeneratsya, 49.27% of OJSC Kolskaya Generating Company and 56.01% of OJSC Petersburg Generating Company) and minorities' shareholdings (50.73% of OJSC Apatitskaya Thermal Power Plant, 50.73% of OJSC Kolskaya Generating Company and 43.99% of OJSC Petersburg Generating Company) were exchanged for the shares of TGC-1.

Merger reserve of RR 13 206 689 thousand as at the opening date represents the difference between the carrying value of the net assets merged into the Company, totalling RR 22 816 099 thousand, and the minority interest of RR 9 609 410 thousand.

13.2 Dividends

In accordance with Russian legislation, the Company distributes profits as dividends or transfers them to reserves (fund accounts) on the basis of financial statements prepared in accordance with Russian Accounting Rules. The statutory accounting reports of the Company are the basis for profit distribution and other appropriations. Russian legislation identifies the basis of distribution as the net profit. For 2006, the current year net statutory profit for the Company as reported in the published annual statutory reporting forms was RR thousand 598 158 thousand (2005: RR 587 314 thousand) and the closing balance of the accumulated losses including the current year net statutory profit totalled RR 15 599 047 thousand (31 December 2005: accumulated profits of RR 587 314 thousand). However, this legislation and other statutory laws and regulations are open to legal interpretation and accordingly management believes at present it would not be appropriate to disclose an amount for the distributable reserves in these consolidated financial statements.

In 2005 OJSC Karelenergogeneratsya declared dividends for the year ended 31 December 2005 of RR 0.158 per share totalling RR 119 163 thousand. All dividends were accrued to RAO UES, its 100% parent.

(in thousands of Russian Roubles)

Note 13. Equity (continued)

In 2006 OJSC Apatitskaya Power Station declared dividends for the year ended 31 December 2006 of RR 0.010514 per share totaling RR 5 000 thousand. Dividends of RR 2 460 thousand were the share of RAO UES, RR 2 540 thousand were the share of minority shareholders.

In 2006 OJSC Kolskaya Generating Company declared dividends for the year ended 31 December 2006 of RR 0.13482 per share totaling RR 64 121 thousand. Dividends of RR 31 421 thousand were the share of RAO UES, RR 32 700 thousand were the share of minority shareholders.

In 2006 OJSC Karelenergogeneratsya declared dividends for the year ended 31 December 2006 of RR 0.04312944 per share totaling RR 32 656 thousand. Dividends of RR 32 656 thousand all accrued to of RAO UES.

In 2006 OJSC Petersburg Generating Company declared dividends for the year ended 31 December 2006 of RR 0.166042 per share totaling RR 149 000 thousand. Dividends of RR 83 447 thousand were the share of RAO UES, RR 65 553 thousand were the share of minority shareholders.

Note 14. Long-Term Borrowings

	Currency	Effective interest rate	Maturity	31 December 2006	31 December 2005
NORDIC investment bank	Euro	EURIBOR + 3%	2014	1 040 895	-
European Bank for Reconstruction and Development	Euro	EURIBOR + 2.75%	2010	971 501	1 231 445
Total long-term borrowings				2 012 396	1 231 445
Less: current portion				(276 056)	(274 265)
Total				**1 736 340**	**957 180**

The fair value of long-term borrowings (including the current portion) was estimated by management on the basis of future contracted cash flows and marketable interest rates on similar instruments applicable to the Company as at 31 December 2006 as RR 1 942 026 thousand (31 December 2005: RR 1 192 812 thousand).

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

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

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

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

	31 December 2006	31 December 2005
Property, plant and equipment	573 941	472 483
Inventories (fuel)	-	117 860
Total	**573 941**	**590 343**

(in thousands of Russian Roubles)

Note 15. Post-Employment Benefits

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

The defined benefit pension plan through NPFE provides for monthly pension benefit paid upon retirement. Annual contributions are made by the Company to the solidarity account in the non-state pension fund. Amount of the contribution is defined by TGC-1 budget and is considered to be enough at least to finance running pension benefits. No part of this contribution is recognised as plan asset as far as TGC-1 can recall this money back and the plan is considered as unfunded thereat. Pension benefits are paid from the solidarity account on 'pay-as-go' basis.

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

The non-statutory pension plan providing monthly pensions had approximately 8 500 active participants as at 31 December 2006 and 2 382 pensioners receiving financial support from the employer.

The tables below provide information about the benefit obligations, plan assets and actuarial estimations used for the years ended 31 December 2006 and 31 December 2005.

Amounts recognised in the balance sheet:

	31 December 2006	31 December 2005
Defined benefit obligations	700 977	458 797
Unrecognised net actuarial losses	(33 602)	-
Unrecognised past service cost	(166 014)	-
Net liability on balance sheet	**501 361**	**458 797**

Amounts recognised in the income statement:

	Year ended 31 December 2006	Year ended 31 December 2005
Current service cost	38 319	28 203
Interest cost	32 116	40 562
Total	**70 435**	**68 765**

Changes in the present value of the Company’s defined benefit obligations are as follows:

	31 December 2006	31 December 2005
Benefit obligations		
Benefit obligations as at the beginning of the period	458 797	402 896
Current service cost	38 319	28 203
Interest cost	32 116	40 562
Past service cost	166 014	-
Benefits paid	(27 871)	(12 864)
Actuarial losses	33 602	-
Benefit obligations as at the end of the period	**700 977**	**458 797**

Principal actuarial estimations are as follows:

	31 December 2006	31 December 2005
Discount rate for benefits at accumulation phase	7.0%	7.0%
Future Salary increase	7.0%	7.0%
Future inflation rate	5.0%	5.0%

(in thousands of Russian Roubles)

Note 16. Short-Term Borrowings and Current Portion of Long-Term Borrowings

Name of creditor	Currency	Effective interest rate, %	31 December 2006	31 December 2005
OJSC “Promstroybank”	RR	8.0-12.5%	1 000 000	24 000
OJSC “Raiffeisen Bank of Austria “	RR	MOSPRIME + 3.25%	1 000 000	1 000 000
JSCB “Promsvyazbank”	RR	8.0%	791 148	-
OJSC “Alfabank”	RR	8.9-12.0%	590 000	83 100
CJSC “Citibank”	RR	8.4-8.5%	500 000	-
OJSC “Rosbank”	RR	8.5%	500 000	-
CJSC “Baltijskiy Bank”	RR	11.0%	3 023	-
OJSC “Sberbank of RF”	RR	7.5-13.0%	-	932 000
OJSC “Bank of Moscow”	RR	10.0%	-	500 000
OJSC “Gazprombank”	RR	10.5%	-	300 000
OJSC “NB Trust”	RR	13.0%	-	19 000
OJSC “Barentsbank”	RR	12.0%	-	10 000
Current portion of long-term borrowings (European Bank for Reconstruction and Development)	Euro	EURIBOR + 2.75%	276 056	274 265
Total			**4 660 227**	**3 142 365**

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

- to maintain the certain level of turnovers on current accounts;
- to maintain certain level of credit balance as a percentage of average liabilities.

Management does not believe that the Company is in danger of breaching the covenants imposed.

Note 17. Accounts Payable and Accrued Liabilities

	31 December 2006	31 December 2005
Trade accounts payables	1 673 664	1 514 187
Advances from customers	1 213 263	606 052
Accounts payable for capital construction	373 621	171 373
Accrued liabilities and other payables	156 056	512 516
Employee benefits	70 430	39 736
Total	**3 487 034**	**2 843 864**

Note 18. Other Taxes Payable

	31 December 2006	31 December 2005
Property tax	121 031	108 736
Water usage tax	68 628	52 662
Value added tax	33 685	819 531
Employee taxes	27 044	41 458
Other taxes	28 504	12 312
Total	**278 892**	**1 034 699**

Valued added tax balance includes RR 31 794 thousand of deferred VAT (31 December 2005: RR 706 988 thousand) originated prior to 2006 which becomes payable upon collection or write-off of underlying accounts receivable.

(in thousands of Russian Roubles)

Note 19. Revenue and Operating Expenses - Supplementary Information

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

Management analyses the Company's business within the following main business lines:

- Hydroelectric Power Stations (HPS)
- Thermal Power Plants (TPP)
- Other operations

For the year ended 31 December 2006:

	HPS	TPP	Other	Total
Revenue				
Sales of electricity	3 671 055	7 540,683	-	11 211 738
Sales of heating	-	9 596 888	-	9 596 888
Other sales	-	351 379	433 697	785 076
Total revenue	**3 671 055**	**17 488 950**	**433 697**	**21 593 702**
Operating expenses	(2 576 788)	(16 533 774)	(2 692 743)	(21 803 305)
Gross Margin	**1 094 267**	**955 176**	**(2 259 046)**	**(209 603)**

For the year ended 31 December 2005:

	HPS	TPP	Other	Total
Revenue				
Sales of electricity	3 876 506	6 971 995	-	10 848 501
Sales of heating	2 985	8 881 145	3 359	8 887 489
Other sales	3 051	286 869	261 656	551 576
Total revenue	**3 882 542**	**16 140 009**	**265 015**	**20 287 566**
Operating expenses	(2 083 684)	(14 685 135)	(1 502 398)	(18 271 217)
Gross Margin	**1 798 858**	**1 454 874**	**(1 237 383)**	**2 016 349**

(in thousands of Russian Roubles)

Note 20. Operating Expenses and Other Operating Income

20.1 Operating expenses:

	Year ended 31 December 2006	Year ended 31 December 2005
Fuel	8 979 435	7 699 233
Employee benefits	3 398 149	2 851 698
Water usage expenses	1 540 715	1 351 909
Depreciation	1 360 694	1 447 050
Electricity and heat purchases	1 210 064	453 980
Repairs and maintenance	1 093 214	998 013
Heat distribution	919 514	853 213
Taxes other than income tax	915 062	1 009 891
Other materials	308 395	392 314
Security services	223 985	182 950
Consulting, legal and audit services	220 315	79 250
Lease expenses	191 651	176 281
Insurance cost	108 996	180 534
Telecommunication services	72 054	83 897
Transportation services	52 132	78 668
Provision for impairment of accounts receivable	11 908	45 615
Other operating expenses	1 197 022	386 721
Total	**21 803 305**	**18 271 217**

20.2 Other operating income:

	Notes	Year ended 31 December 2006	Year ended 31 December 2005
Change in financial assets at fair value through profit and loss	7	475 067	188 509
Gain on disposal of subsidiaries	21	288 268	-
Other operating income		163 851	252 127
Total		**927 186**	**440 636**

Note 21. Disposal of Subsidiaries

In June 2006 the Board of Directors of OJSC Petersburg Generating Company approved the sale of non-core subsidiary OJSC CPRP-Energoservice. In November 2006 the Company sold 100% of shares in OJSC CPRP-Energoservice for RR 450 000 thousand.

In August 2006 the Board of Directors of OJSC Apatitskaya Power Station approved the sale of non-core subsidiary OJSC Teploremont. In December 2006 the Company sold its 51% of shares in OJSC Teploremont for RR 6 132 thousand.

Net assets of OJSC CPRP-Energoservice and OJSC Teploremont at the respective dates of sale were as follows:

	OJSC CPRP-Energoservice	OJSC Teploremont	Total
Current assets	135 139	22 352	157 491
Property, plant and equipment	118 269	4 042	122 311
Other non-current assets	38 267	1 259	39 526
Current liabilities	(122 261)	(23 562)	(145 823)
Non-current liabilities	(3 636)	-	(3 636)
Net assets	**165 778**	**4 091**	**169 869**
% of ownership	100%	51%	-
The Company's share in net assets disposed of	(165 778)	(2 086)	(167 864)
Consideration received	450 000	6 132	456 132
Gain on disposal of subsidiaries	**284 222**	**4 046**	**288 268**

(in thousands of Russian Roubles)

Note 22. Finance Cost

	Year ended 31 December 2006	Year ended 31 December 2005
Interest expense	384 116	45 280
Interest income	(1 421)	(2 488)
Total	**382 695**	**42 792**

Note 23. Earnings Per Share

	Year ended 31 December 2006	Year ended 31 December 2005
Profit attributable to the shareholders of TGC-1	1 561 591	1 092 415
Weighted average number of ordinary shares issued (thousands)	485 694 718	772 603
Profit per ordinary share attributable to the shareholders of TGC-1 – basic and diluted (in RR)	**0.0032**	**1.4139**

Note 24. Commitments

24.1 Sales commitments

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

As at 31 December 2006 the Company had entered into a number of annual electricity sales agreements with CJSC Center for Financial Settlements, CJSC Inter RAO UES, retail companies and large industrial customers. Total amount of electricity sales commitments (net of VAT) was RR 9 622 477 thousand as at 31 December 2006.

24.2 Fuel commitments

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

24.3 Social commitments

The Company contributes 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 service, recreation and other social needs in the geographic areas in which it operates.

Note 25. Contingencies

25.1 Political environment

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

25.2 Insurance

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

25.3 Legal proceedings

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

Note 25. Contingencies (continued)

25.4 Taxation

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 Company 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 accrued. 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.

The Russian transfer pricing legislation introduced on 1 January 1999 provides for the possibility for the tax authorities to make transfer pricing adjustments and impose additional tax liabilities in respect of all controllable transactions, provided that the transaction price differs from the market price by more than 20%.

Controllable transactions include transactions with interdependent parties, as determined under the Russian Tax Code, and all cross-border transactions (irrespective whether performed between related or unrelated parties), transactions where the price applied by a taxpayer differs by more than 20% from the price applied in similar transactions by the same taxpayer within a short period of time, and barter transactions. There is no formal guidance as to how these rules should be applied in practice. The arbitration court practice with this respect is contradictory.

Tax liabilities arising from intercompany transactions are determined using actual transaction prices. It is possible with the evolution of the interpretation of the transfer pricing rules in the Russian Federation and the changes in the approach of the Russian tax authorities, that such transfer prices could potentially be challenged in the future. Given the brief nature of the current Russian transfer pricing rules, the impact of any such challenge cannot be reliably estimated; however, it may be significant.

As at 31 December 2006, management believes that its interpretation of the relevant legislation is appropriate and the Company's tax, currency and customs positions will be sustained. Accordingly, at 31 December 2006 no provision for potential tax liabilities had been recorded (31 December 2005: no provision). The Company estimates that it has potential obligations from exposure to other than remote tax risks of approximately RR 480 500 thousand (31 December 2005: RR 106 300 thousand).

25.5 Environmental matters

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

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

25.6 Guarantees

Guarantees are irrevocable assurances that the Company will make payments in the event that another party cannot meet its obligations. The Company has guaranteed certain obligations of its related parties (see Note 5.2).

25.7 Compliance with covenants

The Company is subject to certain covenants related to its long-term and short-term borrowings (see Notes 14 and 16). Non-compliance with such covenants may result in negative consequences for the Company including growth in the cost of borrowings and declaration of default. The Company's management believes that the Company is in compliance with covenants.

Note 26. Financial Instruments and Financial Risks

26.1 Financial risks

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

26.2 Credit risk

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

Cash has been deposited in the financial institutions with minimal exposure to the default risk at the time of account opening.

26.3 Interest rate risk

The Company's operating profits and cash flows from operating activity are largely not dependent on the changes in market interest rates. The Company is exposed to interest rate risk through market value fluctuations of interest-bearing long-term borrowings; this information is disclosed in Note 14. The majority of interest rates on short-term borrowings are fixed; this information is disclosed in Note 16. The Company's interest-bearing assets are disclosed in Note 9. These receivables are at fixed interest rates and therefore are not subject to interest rate risk.

Interest rate risk is monitored by the Board of Directors who approve the maximum acceptable level of weighted average borrowing cost for a certain period (usually a quarter).

26.4 Fair values

Other than disclosed elsewhere in these consolidated financial statements, management believes that the fair value of its financial assets and liabilities approximates the carrying values.

Note 27. Subsequent Events

Issue of bonds

On 20 March 2007 TGC-1 floated and issued 4 000 000 documentary interest-bearing non-convertible coupon bonds with par value of RR 1 000 each for total amount of RR 4 000 000 thousand. The maturity date of the bonds is till 11 March 2014. The coupon income is paid out every sixth month. The rate of the first coupon was established at the auction at the inception of the issue at the rate of 7.75% p.a. The bonds issue terms provide for the possibility of their earlier redemption by the holders in 2010.

Dividends

Annual dividends for 2006 will be declared at the Company's annual shareholders'meeting in June 2007.

Construction contract with OJSC Power Machines

A construction contract was concluded with OJSC Power Machines on 10 May 2007. The subject matter of the contract is the complex reconstruction of two HPS in the Leningrad region that will lead to an increase of installed capacity by 64.8 MW.

The total amount of the contract is approximately RR 5.5 billion, construction is to be finished in 2012.

(in thousands of Russian Roubles)

Note 27. Subsequent Events (continued)

Acquisition of OJSC Murmanskaya Thermal Power Plant (Murmanskaya TPP)

In May 2007 the Company issued additional ordinary shares in order to exchange them for the shares of Murmanskaya TPP held by RAO UES. After completion of the share exchange, the Company now owns 84.06% of Murmanskaya TPP (90.24% of ordinary shares).

As this transaction was under common control by RAO UES, Murmanskaya TPP will be included in the Company's consolidated financial statements for the year ending 31 December 2007 using predecessor accounting basis, and comparative information for the year ended 31 December 2006 will be restated as if Murmanskaya TPP was a subsidiary of TGC-1 from 1 January 2006. Murmanskaya TPP is currently in the process of preparing its IFRS financial statements for the year ended 31 December 2006. Management's best estimate of the impact of inclusion of Murmanskaya TPP in the Company's consolidated financial statements for the year ended 31 December 2006, is summarised below:

Total assets at 31 December 2006	811 803
Total liabilities at 31 December 2006	(1 263 627)
Net liabilities at 31 December 2006	(451 824)
Net loss for the year ended 31 December 2006	**690 918**