

**OGK-2 GROUP
CONSOLIDATED FINANCIAL STATEMENTS
PREPARED IN ACCORDANCE WITH
INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)
FOR THE YEAR ENDED 31 DECEMBER 2011**



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Independent Auditors' Report

To the Board of Directors of Open Joint Stock Company "The Second Generating Company of the Wholesale Electric Power Market" (OJSC "OGK-2").

We have audited the accompanying consolidated financial statements of OJSC "OGK-2" (the "Company") and its subsidiaries (the "Group"), which comprise the consolidated statement of financial position as at 31 December 2011, the consolidated income statement and consolidated statements of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' 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 about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated 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 consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2011, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

ZAO KPMG

ZAO KPMG

25 April 2011

OGK-2 Group
Consolidated Statement of Financial Position as at 31 December 2011

(in thousands of Russian Roubles)

Notes	31 December 2011	31 December 2010 (Restated)
ASSETS		
Non-current assets		
Property, plant and equipment	106,497,335	92,102,951
Intangible assets	1,297,359	1,578,057
Other non-current assets	3,211,158	3,211,345
Total non-current assets	111,005,852	96,892,353
Current assets		
Cash and cash equivalents	359,116	5,362,378
Trade and other receivables	13,585,399	9,396,684
Inventories	6,158,002	5,932,819
Current income tax prepayments	894,405	34,794
Other current assets	-	34,201
Total current assets	20,996,922	20,760,876
TOTAL ASSETS	132,002,774	117,653,229
EQUITY AND LIABILITIES		
Equity		
Share capital	21,518,239	11,872,828
Ordinary shares	(4,058,238)	(12,037)
Treasury shares	23,916,508	23,916,508
Share premium	41,097,814	51,121,762
Retained earnings	82,474,323	86,899,061
Total equity	82,474,323	86,899,061
Non-current liabilities		
Deferred income tax liabilities	6,234,194	4,908,984
Non-current debt	27,168,240	15,134,527
Retirement benefit obligations	1,682,222	1,530,399
Restoration provision	521,670	518,038
Other long-term liabilities	241,261	602,925
Total non-current liabilities	35,847,587	22,694,873
Current liabilities		
Current debt and current portion of non-current debt	5,601,708	10,290
Trade and other payables	7,431,510	6,958,994
Other taxes payable	597,478	583,660
Current income tax payable	-	457,611
Restoration provision	50,168	48,740
Total current liabilities	13,680,864	8,059,295
Total liabilities	49,528,451	30,754,168
TOTAL EQUITY AND LIABILITIES	132,002,774	117,653,229

General Director

A.A. Mityushov

Chief Accountant

B.Z. Dolgoarshinnih

20 April 2012

OGK-2 Group**Consolidated Income Statement for the year ended 31 December 2011**

(in thousands of Russian Roubles, except for earning per ordinary share information)

	Notes	Year ended 31 December 2011	Year ended 31 December 2010 (Restated)
Revenues	22	104,895,639	96,462,808
Operating expenses	23	(102,366,383)	(89,136,835)
Other operating items		(311,344)	33,119
Operating profit		2,217,912	7,359,092
Finance income	24	138,849	657,079
Finance costs	25	(1,934,398)	(1,603,708)
Profit before income tax		422,363	6,412,463
Income tax charge	14	(412,213)	(1,742,273)
Profit for the year		10,150	4,670,190
Attributable to:			
Shareholders of OJSC OGK-2		10,150	4,670,190
Earning per ordinary share for profit attributable to the shareholders of OJSC OGK-2 – basic and diluted (in Russian Roubles)	26	0.0002	0.0787

The consolidated income statement is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements set out on pages 9 to 45

OGK-2 Group**Consolidated Statement of Comprehensive Income for the year ended 31 December 2011**

(in thousands of Russian Roubles)

	Notes	Year ended 31 December 2011	Year ended 31 December 2010 (Restated)
Profit for the year		10,150	4,670,190
Net change in fair value of available-for-sale investments (net of income tax)	13	(48,781)	41,030
Total comprehensive (expense) / income for the year		(38,631)	4,711,220
Attributable to:			
Shareholders of OJSC OGK-2		(38,631)	4,711,220

The consolidated statement of comprehensive income is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements set out on pages 9 to 45

OGK-2 Group
Consolidated Statement of Cash Flows for the year ended 31 December 2011
(in thousands of Russian Roubles)

	Notes	Year ended 31 December 2011	Year ended 31 December 2010 (Restated)
CASH FLOW FROM OPERATING ACTIVITIES:			
Profit before income tax		422,363	6,412,463
Adjustments to reconcile profit before income tax to net cash provided by operations:			
Depreciation of property, plant and equipment	6	3,610,463	3,116,202
Charge / (reversal) of property, plant and equipment impairment	6	7,208	(4,615)
Amortisation of intangible assets	7	72,075	68,551
Charge of provision for impairment of trade and other receivables	23	1,206,926	1,127,852
Reversal of provision for inventory obsolescence	23	(4,144)	(56,670)
Finance income	24	(138,849)	(657,079)
Finance costs	25	1,934,398	1,603,708
Increase in retirement benefit obligations	23	145,446	134,662
Employee share option plan		-	1,792
Loss on disposal of assets	23	516,520	36,842
Other non-cash items		515,979	62,993
Operating cash flows before working capital changes and income tax paid		8,288,385	11,846,701
Working capital changes:			
(Increase) / decrease in trade and other receivables		(5,297,025)	3,267,131
Payments in respect of retirement benefit obligations		(188,268)	(154,131)
Increase in inventories		(294,203)	(441,135)
Decrease in other current assets		34,201	19,216
Increase in other non-current assets		-	(238,324)
Decrease in trade and other payables		(1,161,676)	(1,619,794)
Decrease in other non-current liabilities		(43,339)	(275,705)
Increase / (decrease) in taxes payable, other than income tax		267,989	(329,733)
Income tax paid in cash		(666,093)	(1,490,471)
Net cash generated from operating activities		939,971	10,583,755
CASH FLOW FROM INVESTING ACTIVITIES:			
Purchase of property, plant and equipment		(17,146,175)	(11,400,461)
Proceeds from sale of property, plant and equipment		23,551	56,457
Purchase of intangible assets		(119,099)	(63,641)
Increase in other non-current assets		(1,700)	-
Proceeds from deposits		-	2,792,450
Interest received		45,935	393,526
Net cash used in investing activities		(17,197,488)	(8,221,669)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from short-term borrowings		25,529,822	19,900,000
Proceeds from long-term borrowings		13,401,877	13,600,000
Repayment of short-term borrowings		(21,529,821)	(24,500,000)
Repayment of long-term borrowings (bonds)		-	(8,388,258)
Interest paid		(1,664,458)	(1,026,715)
Payments under finance lease		(105,250)	(38,468)
Finance lease advance		(14,300)	-
Expenses for share issue		(38,307)	-
Dividend paid by the Group to shareholders of OGK-2		(279,107)	-
Purchase of treasury shares	13	(4,046,201)	(6,458)
Refund of premium paid to secure settlement of share-based payments		-	709,688
Net cash generated from financing activities		11,254,255	249,789
Net (decrease) / increase in cash and cash equivalents		(5,003,262)	2,611,875
Cash and cash equivalents at the beginning of the year	9	5,362,378	2,750,503
Cash and cash equivalents at the end of the year	9	359,116	5,362,378

The consolidated statement of cash flows is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements set out on pages 9 to 45

OGK-2 Group
Consolidated Statement of Changes in Equity for the year ended 31 December 2011
(in thousands of Russian Roubles)

	Share capital	Treasury shares	Share premium	Retained earnings	Total
At 1 January 2010 (Restated)	11,872,828	(5,579)	23,916,508	45,699,062	81,482,819
Profit for the year	-	-	-	4,670,190	4,670,190
Available-for-sale investments	-	-	-	41,030	41,030
Total comprehensive income for the year	-	-	-	4,711,220	4,711,220
Acquisition of treasury shares	-	(6,458)	-	-	(6,458)
Employee share option plan	-	-	-	711,480	711,480
At 31 December 2010 (Restated)	11,872,828	(12,037)	23,916,508	51,121,762	86,899,061
At 1 January 2011 (Restated)	11,872,828	(12,037)	23,916,508	51,121,762	86,899,061
Profit for the year	-	-	-	10,150	10,150
Available-for-sale investments	-	-	-	(48,781)	(48,781)
Total comprehensive expense for the year	-	-	-	(38,631)	(38,631)
Share issue	9,645,411	-	-	(9,683,718)	(38,307)
Dividends	-	-	-	(301,599)	(301,599)
Acquisition of treasury shares (Note 13)	-	(4,046,201)	-	-	(4,046,201)
At 31 December 2011	21,518,239	(4,058,238)	23,916,508	41,097,814	82,474,323

The consolidated statement of changes in equity is to be read in conjunction with the notes to, and forming part of, the consolidated financial statements set out on pages 9 to 45

Note 1. The Group and its operations

Open Joint Stock Company "The Second Generating Company of the Wholesale Electric Power Market" (OJSC "OGK-2", or the "Company") was established on 9 March 2005 within the framework of Russian electricity sector restructuring in accordance with the Resolution No. 1254-r adopted by the Russian Federation Government on 1 September 2003.

On 21 June 2011 the General Shareholders Meeting of OJSC "OGK-2" made a decision to merge OJSC "OGK-2" with another company controlled by Gazprom, Open Joint Stock Company "The Sixth Generating Company of the Wholesale Electric Power Market" ("OJSC "OGK-6") in accordance with terms specified in the OJSC "OGK-2" and OJSC "OGK-6" merger agreement (refer to Note 13). OJSC "OGK-6" was established on 17 March 2005 within the framework of Russian electricity sector restructuring in accordance with the Resolution No. 1254-r adopted by the Russian Federation Government on 1 September 2003. The merger resulted in the transfer of assets and liabilities of OJSC "OGK-6" to OJSC "OGK-2". Upon the completion of the merger OJSC "OGK-6" ceased to exist. The merger has been completed on 1 November 2011.

OJSC "OGK-2" and its following subsidiaries form the OGK-2 Group ("the Group"):

	% owned	
	31 December 2011	31 December 2010
LLC "OGK-InvestProekt" (the former subsidiary of OJSC "OGK-6")	100%	100%
LLC "OGK-2 Finance"	100%	100%

The Group's primary activities are generation and sale of electric and heat power. The Group consists of the following power stations (plants): Troitskaya GRES, Stavropolskaya GRES, Pskovskaya GRES, Serovskaya GRES, Surgutskaya GRES-1, Adlerskaya TES, Kirishskaya GRES, Ryazanskaya GRES, Novochebasskaya GRES, Krasnoyarskaya GRES-2, Cherepovetskaya GRES.

The Company is registered by the Izobilnensk District Inspectorate of the RF Ministry of Taxation of Stavropol Region.

The Company's office is located at 101-3, Vernadskogo Avenue, 119526, Moscow, Russian Federation.

Operating environment of the Group. The Group's operations are primarily located in the Russian Federation. Consequently, the Group is exposed to the economic and financial markets of the Russian Federation which display characteristics of an emerging market. The legal, tax and regulatory frameworks continue development, but are subject to varying interpretations and frequent changes which together with other legal and fiscal impediments contribute to the challenges faced by entities operating in the Russian Federation. The consolidated financial statements reflect management's assessment of the impact of the Russian business environment on the operations and the financial position of the Group. The future business environment may differ from management's assessment.

Relations with the state and current regulation. As at 31 December 2011 the Company is controlled by Gazprom, the largest Russian gas production company.

Until 1 July 2008, Russian Open Joint Stock Company for Energy and Electrification Unified Energy System of Russia ("RAO UES") owned 65.47% of the Company, on 1 July 2008 as part of electric industry restructuring process RAO UES ceased to exist as a separate legal entity. Also as a result of the restructuring process Gazprom Group has obtained control over the Company at this date.

Gazprom Group, in its turn, is controlled by the Russian Federation; therefore, the Russian Government is the ultimate controlling party of the Group as at 31 December 2011 and 31 December 2010.

The Group's customer base includes a large number of entities controlled by or related to the State. The list of the Group's major fuel suppliers includes subsidiaries of Gazprom.

The government of the Russian Federation directly affects the Group's operations through regulations of wholesale and retail sales of electricity and heat exercised by the Federal Service on Tariffs (the "FST") and the Regional Energy Commissions of Moscow and Moscow region (the "RECs"). JSC "System Operator of the United Power System" (the "SO UES"), which is controlled by the Russian Federation, regulates operations of generating assets of the Group.

As described in Note 29, the government's economic, social and other policies could have material effects on the operations of the Group.

Changes in the industry. In January 2011 the process of energy market liberalization, which had started in 2006, was completed. From that moment a competitive wholesale market has been in operation, where electricity and capacity are sold at free, unregulated prices, except for volumes of electricity and capacity sold to the public and categories of consumers of an equivalent status, for whom government tariff regulation still applies.

Starting 2011 the majority of the contracts for electricity and capacity supply were engaged at unregulated prices: free bilateral contracts or on a day-ahead market.

The introduction of the new wholesale market also covered capacity trading. Before the new market rules launch, suppliers were paid only for 85% of installed capacity at a flat-rate tariff. The new rules result in separate tariffs for electricity and capacity. Capacity tariffs are planned to be established at levels sufficient to maintain generation facilities of producers.

According to Russian Federation Government Resolution № 1172 of 27 December 2010 starting 1 January 2011 the capacity is supplied using the following schemes at the wholesale market:

- capacity trading at regulated prices (tariffs) based on sales contracts in volume, intended for supply to the population and consumer groups equivalent to the population;
- supply of capacity at open (unregulated) prices based on competitive selection of capacity: capacity trading by open contracts on capacity sale - provided that this capacity is selected on the basis of competitive selection of capacity;
- delivery of capacity according to contracts for provision of facilities: capacity trading by contracts on sale of capacity produced with the use of generating supply;
- capacity which comes in a forced regime (the generating facilities that are not selected as a result of a competitive selection, supporting their further work, which is necessitated by technological and other reasons).

Contract for provision of facilities provided on the one hand the obligation of suppliers to implement the approved investment program, on the other hand give a guarantee of payment capacity of the new (upgraded) generating facilities.

Note 2. Basis of preparation

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

The Company and each subsidiary of the Company individually maintains its own books of accounts and prepares its statutory financial statements in accordance with the RAR. The accompanying financial statements are based on the statutory records adjusted and reclassified for the purpose of presentation in accordance with IFRS.

Basis of measurement. The consolidated financial statements are prepared on the historical cost basis except:

- Financial investments classified as available-for-sale;
- Defined benefit plan asset is recognised as the net total of the plan assets, plus unrecognised past service cost and unrecognised actuarial losses, less unrecognised actuarial gains and the present value of the defined benefit obligation.

Restatement. These consolidated financial statements have been prepared as if the merger of OJSC "OGK-2" and OJSC "OGK-6" described in Note 1 had been completed prior to 1 January 2010.

As at 1 January 2010 the accounting policy of OJSC "OGK-6" was aligned with the accounting policy of OJSC "OGK-2" and have been applied consistently to all periods presented in these financial statements. As part of this alignment OJSC "OGK-6" changed its accounting policy and presentation as follows:

- Switched from revaluation to historical cost basis of measurement of property, plant and equipment. As a result of this the carrying value of OJSC "OGK-6"'s property, plant and equipment has declined from RR 69,124,560 thousand to RR 55,188,498 thousand.

OGK-2 Group
Notes to Consolidated Financial Statements for the year ended 31 December 2011
(in thousands of Russian Roubles)

- Software and licenses, were reclassified to intangible assets from other non-current assets. As a result intangible assets increased and other non-current assets decreased from nil and RR 942,833 thousand to RR 102,730 thousand and RR 840,103 thousand respectively.
- Prepayments on insurance and other taxes (excluding current profit tax), were reclassified to other receivables from other current assets. As a result trade and other receivables increased from RR 3,288,455 thousand to RR 3,387,386 thousand. Bank deposit was reclassified to other current assets from short-term investments. Short-term investments and other current assets decreased from RR 24,670 thousand and RR 108,462 thousand to nil and RR 34,201 thousand respectively.

All intra-group transactions were eliminated. Subject to these adjustments, all line items (assets, liabilities, revenues, expenses and equity) are added together on line by line basis.

The comparative information has been restated for the effect of the merger of OJSC "OGK-2" and OJSC "OGK-6" as described below:

31 December 2010	As previously reported, 31 December 2010, in thousand RR	Retrospective consolidation of OJSC "OGK-6", in thousand RR	As restated, 31 December 2010, in thousand RR
ASSETS			
Non-current assets			
Property, plant and equipment	36,677,606	55,425,345	92,102,951
Intangible assets	1,475,327	102,730	1,578,057
Other non-current assets	2,608,089	603,256	3,211,345
Total non-current assets	40,761,022	56,131,331	96,892,353
Current assets			
Cash and cash equivalents	3,023,466	2,338,912	5,362,378
Trade and other receivables	6,012,009	3,384,675	9,396,684
Inventories	2,293,939	3,638,880	5,932,819
Current income tax prepayments	28,035	6,759	34,794
Other current assets	-	34,201	34,201
Total current assets	11,357,449	9,403,427	20,760,876
TOTAL ASSETS	52,118,471	65,534,758	117,653,229
EQUITY AND LIABILITIES			
Equity			
Share capital			
Ordinary shares	11,872,828	-	11,872,828
Treasury shares	(12,037)	-	(12,037)
Share premium	23,916,508	-	23,916,508
Retained earnings	4,590,133	46,531,629	51,121,762
Total equity	40,367,432	46,531,629	86,899,061
Non-current liabilities			
Deferred income tax liabilities	1,995,773	2,913,211	4,908,984
Non-current debt	5,000,000	10,134,527	15,134,527
Retirement benefit obligations	632,397	898,002	1,530,399
Restoration provision	518,038	-	518,038
Other long-term liabilities	59,747	543,178	602,925
Total non-current liabilities	8,205,955	14,488,918	22,694,873
Current liabilities			
Current debt and current portion of non-current debt	-	10,290	10,290
Trade and other payables	3,144,644	3,814,350	6,958,994
Other taxes payable	351,700	231,960	583,660
Current income tax	-	457,611	457,611
Restoration provision	48,740	-	48,740
Total current liabilities	3,545,084	4,514,211	8,059,295
Total liabilities	11,751,039	19,003,129	30,754,168
TOTAL EQUITY AND LIABILITIES	52,118,471	65,534,758	117,653,229

OGK-2 Group
Notes to Consolidated Financial Statements for the year ended 31 December 2011
(in thousands of Russian Roubles)

	As previously reported, year ended 31 December 2010, in thousand RR	Retrospective consolidation of OJSC "OGK-6", in thousand RR	As restated, year ended 31 December 2010, in thousand RR
Revenues	47,863,630	48,599,178	96,462,808
Operating expenses	(44,002,333)	(45,134,502)	(89,136,835)
Other operating items	(261,523)	294,642	33,119
Operating profit	3,599,774	3,759,318	7,359,092
Finance income	506,364	150,715	657,079
Finance costs	(889,784)	(713,924)	(1,603,708)
Profit before income tax	3,216,354	3,196,109	6,412,463
Income tax charge	(1,025,189)	(717,084)	(1,742,273)
Profit for the year	2,191,165	2,479,025	4,670,190
Earning per ordinary share for profit attributable to the shareholders of OJSC OGK-2 – basic and diluted (in Russian Roubles)	0.0669	0.0118	0.0787

Functional and presentation currency. The national currency of the Russian Federation is the RR, which is the functional currency of the Company and its subsidiaries and the currency in which these financial statements are presented. All financial information presented in RR has been rounded to the nearest thousand.

Going concern. The accompanying consolidated financial statements have been prepared on a going concern basis, which contemplates the realisation of assets and the satisfaction of liabilities in the normal course of business. The recoverability of the Group's assets, as well as the future operations of the Group, may be significantly affected by the current and future economic environment. The accompanying financial statements do not include any adjustments should the Group be unable to continue as a going concern.

Critical accounting estimates and assumptions. The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgments 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 judgments, apart from those involving estimations, in the process of applying the accounting policies. Judgments that have the most significant effect on the amounts recognized 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:

Provision for impairment of trade and other receivables

Provision for impairment of trade and other receivables is based on the Group's assessment of whether the collectability of specific customer accounts worsened compared to prior estimates. If there is deterioration in a major customer's creditworthiness or actual defaults are higher than the estimates, the actual results could differ from these estimates. See effect of these critical accounting estimates and assumptions in Note 10.

Provision for impairment of property, plant and equipment

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 in the period in which the reduction is identified. If conditions change and management determines that the value of property, plant and equipment and assets under construction has increased, the impairment provision will be fully or partially reversed. See effect of these critical accounting estimates and assumptions in Note 6. As described in Notes 1 and 29, the Government's economic, social and other policies could have material effects on the operations of the Group.

Useful lives of property, plant and equipment

The estimation of the useful lives of items 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. See effect of these critical accounting estimates and assumptions in Note 6.

Tax contingencies

Russian tax legislation is subject to varying interpretations and changes, which can occur frequently. Where the Group management believes it is probable that their interpretation of the relevant legislation and the Group's tax positions cannot be sustained, an appropriate amount is accrued for in these financial statements. See effect of these critical accounting estimates and assumptions in Note 29.

Restoration provision

The Group reviews its decommissioning liability, representing site restoration provisions, at each reporting date and adjusts it to reflect the current best estimate in accordance with IFRIC 1 "Changes in Existing Decommissioning, Restoration and Similar Liabilities". The amount recognized as a provision is the best estimate of the expenditures required to settle the present obligation at the reporting date based on the requirements of the current legislation of the country where the respective operating assets are located. The risks and uncertainties that inevitably surround many events and circumstances are taken into account in reaching the best estimate of a provision. Considerable judgment is required in forecasting future site restoration costs. Future events that may affect the amount required to settle an obligation are reflected in the amount of a provision when there is sufficient objective evidence that they will occur. See effect of these critical accounting estimates and assumptions in Note 21.

Note 3. New accounting developments

The following new Standards, amendments to Standards and Interpretations are not yet effective as at 31 December 2011, and have not been applied in preparing these consolidated financial statements. The Group plans to adopt these pronouncements when they become effective.

IAS 19 (2011) *Employee Benefits*. The amended standard will introduce a number of significant changes to IAS 19. First, the corridor method is removed and, therefore, all changes in the present value of the defined benefit obligation and in the fair value of plan assets will be recognised immediately as they occur. Secondly, the amendment will eliminate the current ability for entities to recognise all changes in the defined benefit obligation and in plan assets in profit or loss. Thirdly, the expected return on plan assets recognised in profit or loss will be calculated based on the rate used to discount the defined benefit obligation. The amended standard shall be applied to annual periods beginning on or after 1 July 2013 and early adoption is permitted. The amendment generally applies retrospectively.

IAS 28 (2011) *Investments in Associates and Joint Ventures* combines the requirements in IAS 28 (2008) and IAS 31 that were carried forward but not incorporated into IFRS 11 and IFRS 12. The amended standard will become effective for annual periods beginning of or after 1 January 2013 with retrospective application required. Early adoption of IAS 28 (2011) is permitted provided the entity also early-adopts IFRS 10, IFRS 11, IFRS 12 and IAS 27 (2011).

IFRS 9 *Financial Instruments* will be effective for annual periods beginning on or after 1 January 2015. The new standard is to be issued in phases and is intended ultimately to replace International Financial Reporting Standard IAS 39 *Financial Instruments: Recognition and Measurement*. The first phase of IFRS 9 was issued in November 2009 and relates to the classification and measurement of financial assets. The second phase regarding classification and measurement of financial liabilities was published in October 2010. The remaining parts of the standard are expected to be issued during 2012. The Group recognises that the new standard introduces many changes to the accounting for financial instruments and is likely to have a significant impact on Group's consolidated financial statements. The impact of these changes will be analysed during the course of the project as further phases of the standard are issued. The Group does not intend to adopt this standard early.

IFRS 10 *Consolidated Financial Statements* will be effective for annual periods beginning on or after 1 January 2013. The new standard supersedes IAS 27 *Consolidated and Separate Financial Statements* and SIC-12 *Consolidation – Special Purpose Entities*. IFRS 10 introduces a single control model which includes entities that are currently within the scope of SIC-12 *Consolidation – Special Purpose Entities*.

Under the new three-step control model, an investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with that investee, has the ability to affect those returns through its power over that investee and there is a link between power and returns. Consolidation procedures are carried forward from IAS 27 (2008). When the adoption of IFRS 10 does not result in a change in the previous consolidation or non-consolidation of an investee, no adjustments to accounting are required on initial application. When the adoption results in a change in the consolidation or non-consolidation of an investee, the new standard may be adopted with either full retrospective application from date that control was obtained or lost or, if not practicable, with limited retrospective application from the beginning of the earliest period for which the application is practicable, which may be the current period. Early adoption of IFRS 10 is permitted provided an entity also early-adopts IFRS 11, IFRS 12, IAS 27 (2011) and IAS 28 (2011). The amendment is expected to have no significant impact on the Group's consolidated financial statements.

IFRS 11 *Joint Arrangements* will be effective for annual periods beginning on or after 1 January 2013 with retrospective application required. The new standard supersedes IAS 31 *Interests in Joint Ventures*. The main change introduced by IFRS 11 is that all joint arrangements are classified either as joint operations, which are consolidated on a proportionate basis, or as joint ventures, for which the equity method is applied. The type of arrangement is determined based on the rights and obligations of the parties to the arrangement arising from joint arrangement's structure, legal form, contractual arrangement and other facts and circumstances. When the adoption of IFRS 11 results a change in the accounting model, the change is accounted for retrospectively from the beginning of the earliest period presented. Under the new standard all parties to a joint arrangement are within the scope of IFRS 11 even if all parties do not participate in the joint control. Early adoption of IFRS 11 is permitted provided the entity also early-adopts IFRS 10, IFRS 12, IAS 27 (2011) and IAS 28 (2011).

IFRS 12 *Disclosure of Interests in Other Entities* will be effective for annual periods beginning on or after 1 January 2013. The new standard contains disclosure requirements for entities that have interests in subsidiaries, joint arrangements, associates and unconsolidated structured entities. Interests are widely defined as contractual and non-contractual involvement that exposes an entity to variability of returns from the performance of the other entity. The expanded and new disclosure requirements aim to provide information to enable the users to evaluate the nature of risks associated with an entity's interests in other entities and the effects of those interests on the entity's financial position, financial performance and cash flows. Entities may present some of the IFRS 12 disclosures early without a need to early-adopt the other new and amended standards. However, if IFRS 12 is early-adopted in full, then IFRS 10, IFRS 11, IAS 27 (2011) and IAS 28 (2011) must also be early-adopted.

IFRS 13 *Fair Value Measurement* will be effective for annual periods beginning on or after 1 January 2013. The new standard replaces the fair value measurement guidance contained in individual IFRSs with a single source of fair value measurement guidance. It provides a revised definition of fair value, establishes a framework for measuring fair value and sets out disclosure requirements for fair value measurements. IFRS 13 does not introduce new requirements to measure assets or liabilities at fair value, nor does it eliminate the practicability exceptions to fair value measurement that currently exist in certain standards. The standard is applied prospectively with early adoption permitted. Comparative disclosure information is not required for periods before the date of initial application.

Amendment to IAS 1 *Presentation of Financial Statements: Presentation of Items of Other Comprehensive Income*. The amendment requires that an entity presents separately items of other comprehensive income that may be reclassified to profit or loss in the future from those that will never be reclassified to profit or loss. Additionally, the amendment changes the title of the statement of comprehensive income to statement of profit or loss and other comprehensive income. However, the use of other titles is permitted. The amendment shall be applied retrospectively from 1 July 2012 and early adoption is permitted.

Amendment to IFRS 7 *Disclosures – Transfers of Financial Assets* introduces additional disclosure requirements for transfers of financial assets in situations where assets are not derecognised in their entirety or where the assets are derecognised in their entirety but a continuing involvement in the transferred assets is retained. The new disclosure requirements are designated to enable the users of financial statements to better understand the nature of the risks and rewards associated with these assets. The amendment is effective for annual periods beginning on or after 1 July 2011.

Various *Improvements to IFRSs* have been dealt with on a standard-by-standard basis. All amendments, which result in accounting changes for presentation, recognition or measurement purposes, will come into

effect for annual periods beginning after 1 January 2011. The Group has not yet analysed the likely impact of the improvements on its financial position or performance.

The Group has not yet analysed the likely impact of the new as Standards, amendments to Standards and Interpretations on its financial position or performance, except as stated above.

Note 4. Summary of significant accounting policies

Principles of consolidation. The financial statements comprise the financial statements of the Company and those entities whose operations are controlled by the Company.

A) 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. Non-controlling interest is disclosed as part of equity.

B) Transactions eliminated on consolidation

Inter-company balances and transactions and any unrealized gains arising from inter-company transactions, are eliminated in preparing these financial statements.

Transfers of businesses from parties under common control. The Group was formed by the combination of a number of businesses under common control. Contributions to share capital of shares in subsidiaries (businesses) from parties under common control are accounted for using predecessor basis of accounting. Business combinations arising from transfers of interests in entities that are under the control of the shareholder that controls the Group are accounted for as if the acquisition had occurred at the beginning of the earliest comparative period presented or, if later, at the date that common control was established; for this purpose comparatives are restated. The assets and liabilities of the subsidiaries transferred under common control are accounted for at the predecessor entity's carrying amounts. Because of the consequent use of the predecessor basis of accounting, the principal component of the net equity recognised for the Group is based on the historic carrying value of the net assets of the businesses contributed as recorded in the IFRS financial records of the predecessor enterprises, rather than the fair values of those net assets. In accordance with the predecessor basis of accounting any difference between the carrying amount of net assets and the nominal value of share capital contributed and share premium is accounted for in these financial statements as retained earnings.

Foreign currency. Monetary assets and liabilities, held by the Group and denominated in foreign currencies at the reporting 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 the monetary assets and liabilities denominated in foreign currencies are recognized in the income statement.

The official Russian Rouble to US dollar exchange rates as determined by the Central Bank of the Russian Federation were 32.1961 and 30.4769 as at 31 December 2011 and 31 December 2010, respectively. The official RR to EURO exchange rates as determined by the Central Bank of the Russian Federation were 41.6714 and 40.3331 as at 31 December 2011 and 31 December 2010, respectively.

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

Property, plant and equipment. Following the predecessor basis of accounting property, plant and equipment were recognized at the carrying value determined in accordance with IFRS by the predecessors.

Property, plant and equipment are stated at depreciated cost less impairment. Adjustments are made for additions, disposals and depreciation charges. At each reporting date management assesses whether there is any indication of impairment of property, plant and equipment. If any such indication exists, management estimates the recoverable amount which is determined as the higher of an asset's fair value less costs to sell and its value in use. The carrying amount is reduced to the recoverable amount and the difference is recognised as an expense (impairment loss) in the income statement. An impairment loss recognised in prior years is reversed if there has been an increase in the estimated fair value or value in use used to determine an asset's recoverable amount.

Renewals and improvements are capitalised and the assets replaced are retired. The cost of repair and maintenance is expensed as incurred. 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 Group. Costs associated with a fulfilment of the Group's social responsibilities are expensed as incurred.

Land is not depreciated. Depreciation of other assets is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives. Depreciation of property, plant and equipment, evaluated by the independent appraisers at 31 December 1997, was calculated using depreciation rates based on remaining useful lives identified on the date of evaluation.

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

The remaining useful lives, in years, are as follows:

Classes of property, plant and equipment	At 31 December 2010	At 31 December 2011
Production buildings	26-43	25-42
Constructions	8-31	7-30
Energy machinery and equipment	8-25	7-24
Other machinery and equipment	2-25	1-24
Other	2-19	2-18

Financial instruments - key measurement terms. Depending on their classification financial instruments are carried at fair value, cost, or amortised cost as described below.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Fair value is the current bid price for financial assets and current asking price for financial liabilities which are quoted in an active market. For assets and liabilities with offsetting market risks, the Group may use mid-market prices as a basis for establishing fair values for the offsetting risk positions and apply the bid or asking price to the net open position as appropriate. A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange or other institution and those prices represent actual and regularly occurring market transactions on an arm's length basis.

Valuation techniques such as discounted cash flow models or models based on recent arm's length transactions or consideration of financial data of the investees are used to fair value certain financial instruments for which external market pricing information is not available. Valuation techniques may require assumptions not supported by observable market data. Disclosures are made in these financial statements if changing any such assumptions to a reasonably possible alternative would result in significantly different profit, income, total assets or total liabilities.

Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial instrument. An incremental cost is one that would not have been incurred if the transaction had not taken place. Transaction costs include fees and commissions paid to agents (including employees acting as selling agents), advisors, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs.

Amortised cost is the amount at initial recognition less any principal repayments, plus accrued interest, and for financial assets less any write-down for incurred impairment losses. Accrued interest includes amortisation of transaction costs deferred at initial recognition and of any premium or discount to maturity amount using the effective interest method. Accrued interest income and accrued interest expense, including both accrued coupon and amortised discount or premium (including fees deferred at origination, if any), are not presented separately and are included in the carrying values of related items in the statement of financial position.

The *effective interest method* is a method of allocating interest income or interest expense over the relevant period so as to achieve a constant periodic rate of interest (effective interest rate) on the carrying amount. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts (excluding future credit losses) through the expected life of the financial instrument or a shorter period, if appropriate, to the net carrying amount of the financial instrument. The effective interest rate discounts cash flows of variable interest instruments to the next interest repricing date except for the premium or discount which reflects the credit spread over the floating rate specified in the instrument, or other variables that are not reset to market rates. Such premiums or discounts are amortised over the whole expected life of the instrument. The present value calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate.

Classification of financial assets. The Group classifies its financial assets into the following categories: loans and receivables and available-for-sale investments. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition.

(a) *Loans and receivables.* Loans and receivables are non-derivative financial assets with fixed or determinable payment terms, which are not quoted on an active market. These assets are included into the current assets except when the maturity is greater than 12 months after the reporting date. These assets are classified as non-current assets.

(b) *Available-for-sale investments.* Available-for-sale financial assets include investment securities which the Group intends to hold for an indefinite period of time and which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the reporting date.

Initial recognition of financial instruments. All financial instruments are initially recorded at fair value plus transaction costs. Fair value at initial recognition is best evidenced by the transaction price. A gain or loss on initial recognition is only recorded if there is a difference between fair value and transaction price which can be evidenced by other observable current market transactions involving a similar instrument or by a valuation technique whose inputs include data from observable markets.

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

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

Available-for-sale investments. Available-for-sale investments are carried at fair value. Interest income on available-for-sale debt securities is calculated using the effective interest method and recognised in profit or loss for the year as finance income. Dividends on available-for-sale equity instruments are recognised in profit or loss for the year as finance income when the Group's right to receive a dividend is established and it is probable that the dividends will be received. All other elements of changes in the fair value are recognised in other comprehensive income until the investment is derecognised or impaired at which time the cumulative gain or loss is reclassified from other comprehensive income to finance income in profit or loss for the year.

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

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

Trade and other receivables. Trade and other receivables are recorded inclusive of value added taxes. Trade and other receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. In practice, the entity has estimated that the nominal amount of trade and other receivables approximates the fair value at inception. A provision for impairment of trade receivables is established when there is an objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments (more than 90 days overdue) are considered indicators that the receivable is impaired. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate for similar borrowers. The carrying amount of the asset is reduced through the use of an impairment provision account, and the amount of the loss is recognised in the income statement within operating expenses. When a receivable is uncollectible, it is written off against the impairment provision account for receivables. Subsequent recoveries of amounts previously written off are credited against operating expenses in the income statement.

Derecognition of non-derivative financial liabilities. The Group derecognises a financial liability when its contractual obligations are discharged or cancelled or expire. The Group classifies non-derivative financial liabilities into the other financial liabilities category. Such financial liabilities are recognised initially at fair value less any directly attributable transaction costs. Subsequent to initial recognition, these financial liabilities are measured at amortised cost using the effective interest method. Other financial liabilities comprise loans and borrowings and trade and other payables.

Trade and other payables and accrued charges. Trade and other payables are stated inclusive of value added tax. Trade payables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest rate method. If trade and other payables are restructured and the discounted present value of the cash flows under the restructured terms discounted using the original effective interest rate differs by more than ten percent from the discounted present value of the remaining cash flows of the original financial liability, then the fair value of the restructured payable is measured as the discounted present value of the cash flows under the restructured terms. In this case the amount of the discount is credited to the income statement (finance costs) as a gain on restructuring, and the non-current portion of the discounted payable is classified as other non-current liabilities. The discount is amortized as interest expense.

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

Treasury shares. Where the Company or its subsidiaries purchase the Company's equity instruments, the consideration paid, including any directly attributable incremental costs, net of income taxes, is deducted from equity attributable to the Company's owners until the equity instruments 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 owners.

Debt. Debt is recognized initially at its' fair value. In subsequent periods, debt is stated at amortized cost using the effective yield method; any difference between the fair value at initial recognition (net of transaction costs) and the redemption amount is recognized in the income statement as an interest expense over the period of the debt obligation.

Environmental liabilities. Liabilities for environmental remediation are recorded where there is a present legal obligation as a result of past events, the payment is probable and reliable estimates can be made.

Value added tax on purchases and sales (VAT). Output VAT related to sales is payable to tax authorities on the earlier of (a) receipt of advance from customers or (b) delivery of goods or services to customers. Input VAT is generally recoverable against output VAT upon receipt of goods or services and the respective VAT invoice. Input VAT from advances paid to suppliers after 1 January 2009 is recoverable upon advance payment provided the receipt of respective VAT invoice.

The tax authorities permit the settlement of VAT on net basis. VAT related to sales and purchases is recognized in the statement of financial position at nominal value 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.

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

Intangible assets. The Company's intangible assets have definite useful lives and primarily include capitalised computer software and licences. Acquired computer software and licences, are capitalised on the basis of the costs incurred to acquire and bring them to use.

Development costs that are directly associated with identifiable and unique software controlled by the Company are recorded as intangible assets if an inflow of incremental economic benefits exceeding costs is probable. Capitalised costs include staff costs of the software development team and an appropriate portion of relevant overheads. Maintenance costs associated with computer software are expensed when incurred. Capitalised computer software is amortised on a straight line basis over expected useful lives.

Intangible assets are reviewed for impairment whenever the events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use.

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

Deferred income tax. Deferred tax is provided using the balance sheet liability method for the temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for the 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 or loss. Deferred tax balances are measured at tax rates enacted or substantively enacted at the reporting date which are expected to apply to the period when the temporary differences will reverse or the tax loss carry forwards will be utilized. Deferred tax assets and liabilities are netted only within the individual companies of the Group. Deferred tax assets for deductible temporary differences and tax loss carry forwards are recorded only to the extent that it is probable that future taxable profit will be available against which the deductions can be utilized.

Deferred tax movements are recorded in the income statement except when they are related to the items directly charged to the shareholders' equity. In this case deferred taxes are recorded as part of the shareholders' equity.

Prepayments/Advances paid. Prepayments/advances paid are carried at cost less provision for impairment. A prepayment/advance paid is classified as non-current when the goods or services relating to the prepayment/advance paid are expected to be obtained after one year, or when the prepayment relates to an asset which will itself be classified as non-current upon initial recognition. Prepayments/advances paid to acquire assets are transferred to the carrying amount of the asset once the Group has obtained control of the asset and it is probable that future economic benefits associated with the asset will flow to the Group. Advances paid to capital contractors and to acquire intangible assets are included into carrying amount of construction in progress balance of property, plant and equipment and intangible assets balance, respectively, excluding related input VAT. Input VAT from the advances paid is included into carrying amount of other non-current assets. The input VAT is stated at its nominal value. Other prepayments/advances paid offset when the goods or services relating to the prepayments/advances are received. If there is an indication that the assets, goods or services relating to a prepayment/advances paid will not be received, the carrying value of the prepayment advance paid is written down accordingly and a corresponding impairment loss is recognised in profit or loss.

Borrowing costs. Prior to 1 January 2009, the Group recognised all borrowing costs as an expense in the period in which they are incurred.

Starting from 1 January 2009 the Group adopted revised IAS 23 Borrowing Costs. The main change is the removal of the option of immediately recognising as an expense borrowing costs related to assets that take a substantial period of time to get ready for use or sale.

Borrowing costs that are directly attributable to the acquisition, construction or production of an asset that necessarily takes a substantial period of time to get ready for its intended use or sale (a qualifying asset) form part of the cost of that asset, if the commencement date for capitalisation is on or after 1 January 2009. Other borrowing costs are recognised as an expense using the effective interest method.

The Group capitalises borrowing costs that would have been avoided if it had not made capital expenditure on qualifying assets. The commencement date for capitalisation is when (i) the Group incurs expenditures for the qualifying asset; (ii) it incurs borrowing costs; and (iii) it undertakes activities that are necessary to prepare the asset for its intended use or sale. Capitalisation ceases when all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

Interest or other investment income is not deducted in arriving at the amount of borrowing costs available for capitalisation, except where the Group obtains specific borrowings for the purpose of acquiring a qualifying asset and has investment income on the temporary investment of funds obtained through such specific borrowings.

Financial guarantees. Financial guarantees are contracts that require the Group to make specified payments to reimburse the holder of the guarantee for a loss it incurs because a specified debtor fails to make a payment when due in accordance with the terms of a debt instrument. Financial guarantees are initially recognised at their fair value, which is normally evidenced by the amount of fees received. This amount is amortised on a straight line basis over the life of the guarantee. At the end of each reporting period, the guarantees are measured at the higher of (i) the remaining unamortised balance of the amount at initial recognition and (ii) the best estimate of expenditure required to settle the obligation at the end of the reporting period.

Restoration provision. Estimated costs of dismantling and removing an item of property, plant and equipment (asset retirement obligations) are added to the cost of the item either when an item is acquired or as the item is used during a particular period for purposes other than to produce inventories during that period. Changes in the measurement of an existing asset retirement obligation result from changes in the estimated timing or amount of the outflows, or from changes in the discount rate. These changes adjust the cost of the related asset in the current period for assets carried under the cost model. The Group has an obligation to restore the surface of ash dumps when they are full.

Finance leases. Where the Group is a lessee in a lease which transfers substantially all the risks and rewards incidental to ownership to the Group, the assets leased are capitalised in property, plant and equipment at the commencement of the lease at the lower of the fair value of the leased asset and the present value of the minimum lease payments. The corresponding rental obligations, net of future finance charges, are included in debts. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding. The interest cost is charged to the income statement over the lease period using the effective interest method.

Operating leases. Management applies judgment in determining whether to account for lease agreements as finance or operating leases. In the application of this judgment, management makes assessment of various factors including which party carries the risks and rewards of ownership, the extent of the lease term and whether early termination clauses can be exercised by the counterparties to the lease.

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

When assets are leased out under an operating lease, the lease payments receivable are recognised as rental income on a straight-line basis over the lease term.

Pension and post-employment benefits. In the normal course of business the Group contributes to the Russian Federation defined contribution state pension scheme on behalf of its employees. Mandatory contributions to the governmental pension scheme are expensed when incurred and included in employee benefit expenses and social funds contributions in the income statement.

Benefit plans define the amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and compensation. The liability recognised in the statement of financial position in respect of defined benefit pension plans operated by