

OPEN JOINT STOCK COMPANY "HC "OZNA" AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008 (in thousand of Russian Rubles)

1. GENERAL INFORMATION

General information

The Group includes the parent company, Open Joint Stock Company "Holding Company "OZNA" (the "Company" or "HC OZNA") and its subsidiaries ("The Group" or "OZNA Group").

HC OZNA was incorporated in 2008. The Company is located at 5/2 Lenina Street, Ufa, Republic of Bashkortostan, 450077 Russian Federation. See Group reorganization below for the explanation of the change in the holding Company of the Group.

The principal activities of the Group and its subsidiaries are: projecting objects of oil & gas industry, the production, guarantee and support manning of the oil and gas equipment, construction engineering research, and engineering in oil, gas, water and oil & gas objects automation sphere.

The significant subsidiaries of the Group are:

Company name	Place of incorporation and operation	Activity	Effective interest held as at:	
			31 December 2008	31 December 2007*
OJSC "HC "OZNA"	Ufa	Holding Company. Finance and industrial groups' and holding companies' management	-	-
LLC "OZNA-Management"	Ufa	Management services	100.00%	-
OJSC "AK OZNA"	Ufa	Production and sales of oil and gas equipment	100.00%	Parent
LLC "OZNA- Engineering"	Ufa	Production and sale of hi-tech oil and gas equipment	100.00%	100.00%
LLC "OZNA -West Siberia"	Moscow	Sales of oil and gas equipment in North-West region	51.00%	51.00%
CJSC "Nature Development Institute"	Nizhneartovsk	Services in development works for new oil fields	74.80%	74.80%
LLC "OZNAservice"	Oktyabrski	Servicing and installation of equipment	100.00%	100.00%
LLC "Automation means control"	Nizhneartovsk	Maintenance of automation devices of extraction objects and oil treating	100.00%	-
LLC Hotel "Tonus"	Oktyabrski	Hotel	100.00%	100.00%
LLC "OZNA-Finance"	Oktyabrski	Special purpose entity for issuing bonds	100.00%	100.00%
LLC "Center of real estate management"	Oktyabrski	Management of social facilities	-	99.44%

* Ownership by OJSC "AK OZNA"

All the above companies are registered in the Russian Federation.

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The number of employees of the Group at 31 December 2008 and at 31 December 2007 was 3,254 and 3,001 employees respectively.

Group reorganization

In 2008 the Group was reorganized through a series of transactions under common control. On 17 March 2008 OJSC "Holding Company OZNA" was established. The purpose of foundation of HC OZNA was to concentrate the ownership over all group companies in newly created company.

The share capital of HC OZNA was established at the amount of RUB 504,369 thousand and divided into 504,369,264 shares with face value 1 RUB per each share.

The shareholders of the OJSC "AK OZNA" (further AK OZNA), Group's parent in 2007, became shareholders of HC OZNA in exchange for the shares of AK OZNA.

Subsequently, in the course of 2008, the investment of AK OZNA in LLC "OZNA- Engineering", LLC "OZNAServis", LLC "OZNA-Finans", LLC "OZNA -West Siberia", LLC "Automation means control" were transferred to HC OZNA.

The Group presented the Group reorganization as if all the related transactions happened at the beginning of the earliest comparative period presented in these consolidated financial statements.

2. BASIC APPROACHES IN CONSOLIDATED FINANCIAL STATEMENTS COMPILING AND KEY PRINCIPLE OF ACCOUNT POLICY

Basic of preparation

The consolidated financial statements of the Group for the year ended 31 December 2008 have been prepared in accordance with International Financial Reporting Standards (the "IFRS"), which includes standards and interpretations approved by the International Accounting Standards Board (the "IASB"), including International Accounting Standards and interpretations issued by the International Financial Reporting Interpretations Committee (the "IFRIC"), which replaced the Standing Interpretations Committee.

The consolidated financial statements of the Group have been prepared on the historical cost basis, except for the valuation of property, plant and equipment, which has been presented at fair value, as determined by independent appraisers at the date of transition to IFRS.

Reclassification of comparable data

Certain reclassifications of cooperative information balances have been made in consolidated balance sheet, consolidated income statement, consolidated statement of cash flows and notes to the consolidated financial statement having an aim to conform to the current year presentation.

Functional currency

The functional currency used by the Group's entities is the Russian Ruble ("RUR") representing the currency of the primary economic environment in which the group operates.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of OJSC "HC "OZNA" and its subsidiaries, from the date that control effectively commenced until the date that control effectively ceased. Control is achieved where the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

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The assets and liabilities of all subsidiaries are measured at their fair values at the date of acquisition.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

The financial statements of subsidiaries are prepared for the same reporting period as those of OJSC "HC "OZNA". Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used by them into line with those of the Group.

All intra-group balances, transactions, and any unrealized profits or losses arising from intra-group transactions, are eliminated on consolidation.

Minority interests in the net assets (excluding goodwill) of consolidated subsidiaries are identified separately from the interests of the equity holders of the parent company.

Minority interests consist of the amount of those interests at the date of the original business combination and the minority's share of changes in equity since the date of the combination. Losses applicable to the minority in excess of the minority's interest in the subsidiary's equity are allocated against the interest of the Group, except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses.

Business combinations

Acquisitions of subsidiaries and businesses are accounted for using the purchase method. The cost of the business combination is measured as the aggregate of the fair values (at the date of exchange) of assets given, liabilities incurred or assumed, and equity instruments issued by the Group in exchange for control of the acquire, plus any costs directly attributable to the business combination. The acquirer's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under IFRS 3 "Business Combinations" are recognised at their fair values at the acquisition date, except for non-current assets (or disposal groups) that are classified as held for sale in accordance with IFRS 5 "Non-current Assets Held for Sale and Discontinued Operations", which are recognised and measured at fair value less costs to sell.

Investments in associates

An associate is an entity over which the Group has significant influence and that is neither a subsidiary nor an interest in a joint venture. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies.

The results and assets and liabilities of associates are incorporated in these consolidated financial statements using the equity method of accounting.

Under the equity method, investments in associates are carried in the consolidated balance sheet at cost as adjusted for post-acquisition changes in the Group's share of the net assets of the associate, less any impairment in the value of individual investments. Losses of an associate in excess of the Group's interest in that associate (which includes any long-term interests that, in substance, form part of the Group's net investment in the associate) are recognised only to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate.

Any excess of the cost of acquisition over the Group's share of the net fair value of the identifiable assets, liabilities and contingent liabilities of the associate recognised at the date of acquisition is recognised as goodwill. The goodwill is included within the carrying amount of the investment and is assessed for impairment as part of the investment. Any excess of the Group's share of the net fair value of the identifiable assets, liabilities and contingent liabilities over the cost of acquisition, after reassessment, is recognised immediately in profit or loss.

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Profit and losses resulting from transactions with associates are eliminated to the extent of the Group's interest in these associates.

Goodwill

Goodwill arising on the acquisition of a subsidiary represents the excess of the cost of the acquisition over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities of the subsidiary recognised at the date of acquisition. Goodwill is initially recognised as an asset at cost and is subsequently measured at cost less any accumulated impairment losses. If the Group's interest in net fair value of the identifiable assets, liabilities and contingent liabilities of the subsidiary exceeds the cost of the acquisition, the difference is recognised immediately in profit or loss.

For the purpose of impairment testing, goodwill is allocated to each of the Group's cash-generating units expected to benefit from the synergy of the combination. Cash-generating units to which goodwill has been allocated are tested for impairment annually, or more frequently when there is an indication that the unit may be impaired. If the recoverable amount of the cash-generating unit is less than carrying amount of the unit, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then to the other assets of the unit pro-rata on the basis of the carrying amount of each asset in the unit. An impairment loss recognised for goodwill is not reversed in a subsequent period.

On disposal of a subsidiary or an interest in a joint venture, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

The Group's policy for goodwill arising on the acquisition of an associate is described under 'Investments in associates' above.

Non-current assets held for sale

Non-current assets and disposal groups are classified as held for sale if their carrying amount will be recovered principally through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset (or disposal group) is available for immediate sale in its present condition. Management must be committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of classification.

Non-current assets (and disposal groups) classified as held for sale are measured at the lower of their previous carrying amount and fair value less costs to sell.

Foreign currencies

In preparing the financial statements of the individual entities, transactions in currencies other than the entity's functional currency (foreign currencies) are recorded at the exchange rates prevailing on the dates of the transactions. At each balance sheet date, monetary assets and liabilities denominated in foreign currencies are translated at the exchange rates prevailing at the balance sheet date. Non-monetary items carried at historical cost are translated at the exchange rate prevailing on the date of the transaction.

Exchange differences are recognised in profit or loss in the period in which they arise as a component of other income or expense, except for exchange differences which relate to assets under construction for future productive use, which are included in the cost of those assets, where they are regarded as an adjustment to interest costs on foreign currency borrowings.

Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods and services provided in the normal course of business, net of discounts and value-added tax.

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Revenue from the sale of bush block pump stations, measuring stations and other equipment (finished goods) is recognised when the following conditions are satisfied:

- The Group has transferred to the buyer the significant risks and rewards of ownership, upon finished goods delivery;
- The Group retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;
- The amount of revenue can be measured reliably;
- It is probable that the economic benefits associated with the transaction will flow to the Group; and
- The costs incurred or to be incurred in respect of the transaction can be measured reliably.

Revenue from rendering of services is recognised at the time the services are provided.

Interest income is accrued on timely basis, by reference to the principal outstanding and at the effective interest rate applicable.

Dividend income from investments is recognised when the shareholders' rights to receive payments have been established.

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale.

Transaction costs associated with the issuance of a debt instrument are recorded as a reduction of the debt liability, and are amortised to interest expense over the term of the related debt. In any period in which the debt is redeemed, the unamortised costs relating to the debt being redeemed are expensed.

All other borrowing costs are recognised in profit or loss in the period in which they are incurred.

Property, plant and equipment

The date of initial application of IFRS for the Group was 1 January 2005. The Group elected to utilize exemptions available for first-time adopters under IFRS 1 and recorded property, plant and equipment at fair value. The valuations were performed by an independent appraiser. The difference between the fair value of the property, plant and equipment and its cost in Russian GAAP at 1 January 2005 was recorded as retained earnings at that date, net of effect of deferred tax.

Property, plant and equipment acquired through acquisitions of subsidiaries are recorded at fair value on the date of the acquisition, as determined by an independent appraiser.

Additions to property, plant and equipment are recorded at cost. Cost includes expenditure that is directly attributable to the acquisition of the items. Subsequent costs, including overhaul expenses, are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably.

Capitalised cost includes major expenditures for improvements and replacements. Repairs and maintenance expenditures that do not meet the foregoing criteria for capitalisation are charged to income statement as incurred.

Depreciation is charged so as to write off the cost or valuation of assets, other than land and property under construction, over their estimated useful lives, using the straight-line method.

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The estimated useful lives of the various classes of assets are as follows:

Land	indefinite
Buildings	50 years
Transmissions	20 years
Constructions	10 years
Machinery and equipment	10 years
Household equipment	10 years
Production, measuring and electric equipment	5 years
Vehicles	4 years
Computer equipment and household appliances	3 years

Construction in progress comprises costs directly related to the construction of property, plant and equipment including an appropriate allocation of directly attributable variable overheads that are incurred in construction as well as costs of purchase of other assets that require installation or preparation for their use. Cost includes, for qualifying assets, borrowing costs capitalized in accordance with the Group's accounting policy. Depreciation of these assets, on the same basis as for other property assets, commences when the assets are put into operation. Construction in progress is reviewed regularly to determine whether its carrying value is fairly stated and whether appropriate provision for impairment is made.

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in profit or loss statement.

Intangible assets, other than goodwill

Intangible assets acquired separately are reported at cost less accumulated amortisation and accumulated impairment losses. Amortisation is charged on a straight-line basis over their estimated useful lives. The estimated useful life and amortisation method are reviewed at the end of each annual reporting period, with the effect of any changes in estimate being accounted for on a prospective basis. Intangible assets include capitalized development costs, software, licenses and patents and are amortized over their respective useful lives of 3 to 10 years.

Impairment of tangible and intangible assets excluding goodwill

At each balance sheet date, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Intangible assets with indefinite useful lives and intangible assets not yet available for use are tested for impairment annually, and whenever there is an indication that the asset may be impaired.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised immediately in profit or loss.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is recognised immediately in profit or loss.

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Inventories

Inventories are stated at the lower of cost and net realisable value. Cost comprises direct materials and, where applicable, direct labour costs and those overheads that have been incurred in bringing the inventories to their present location and condition. Cost is calculated using the first-in-first-out ("FIFO") method. Net realisable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and distribution.

Financial assets

Investments are recognised and derecognised on a trade date where the purchase or sale of an investment is under a contract whose terms require delivery of the investment within the timeframe established by the market concerned, and are initially measured at fair value, plus transaction costs, except for those financial assets classified as at fair value through profit or loss, which are initially measured at fair value.

Financial assets are classified into the following specified categories:

- Financial assets at fair value through profit or loss ("FVTPL");
- Held-to-maturity investments;
- Available-for-sale ("AFS") financial assets; and
- Loans and receivables.

The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

Effective interest method

The effective interest method is a method of calculating the amortised cost of a financial asset and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset, or, where appropriate, a shorter period.

Income is recognised on an effective interest rate basis for debt instruments other than those financial assets designated as at FVTPL.

Financial assets at FVTPL

Financial assets are classified as at FVTPL where the financial asset is either held for trading or it is designated as at FVTPL.

A financial asset is classified as held for trading if:

- It has been acquired principally for the purpose of selling in the near future; or
- It is a part of an identified portfolio of financial instruments that the Group manages together and has a recent actual pattern of short-term profit-taking; or
- It is a derivative that is not designated and effective as a hedging instrument.

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A financial asset other than a financial asset held for trading may be designated as at FVTPL upon initial recognition if:

- Such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise; or
- The financial asset forms part of a group of financial assets or financial liabilities or both, which is managed and its performance is evaluated on a fair value basis, in accordance with the Group's documented risk management or investment strategy, and information about the grouping is provided internally on that basis; or
- It forms part of a contract containing one or more embedded derivatives, and IAS 39 permits the entire combined contract (asset or liability) to be designated as at FVTPL.

Financial assets at FVTPL are stated at fair value, with any resultant gain or loss recognised in profit or loss. The net gain or loss recognised in profit or loss incorporates any dividend or interest earned on the financial asset. Fair value is determined in the manner described in Note 26.

Held-to-maturity investments

Bills of exchange and debentures with fixed or determinable payments and fixed maturity dates that the Group has the positive intent and ability to hold to maturity are classified as held-to-maturity investments. Held-to-maturity investments are recorded at amortised cost using the effective interest method less impairment, with revenue recognised on an effective yield basis.

AFS financial assets

Listed shares and listed redeemable notes held by the Group that are traded in an active market are classified as being AFS and are stated at fair value. Fair value of AFS is determined as follows:

- The fair value of AFS financial assets with standard terms and conditions and traded on active liquid markets are determined with reference to quoted market prices; and
- The fair value of other AFS financial assets are determined in accordance with generally accepted pricing model based on discounted cash flow analysis using prices from observable current market transactions.

Gains and losses arising from changes in fair value are recognised directly in equity in the investments revaluation reserve with the exception of impairment losses, interest calculated using the effective interest rate method and foreign exchange gains and losses on monetary assets, which are recognised directly in profit or loss. Where the investment is disposed of or is determined to be impaired, the cumulative gain or loss previously recognised in the investments revaluation reserve is included in profit or loss for the period.

Dividends on AFS equity instruments are recognised in profit or loss when the Group's right to receive payments is established.

The fair value of AFS monetary assets denominated in a foreign currency is determined in that foreign currency and translated at the spot rate at the balance sheet date. The change in fair value attributable to translation differences that result from a change in amortised cost of the asset is recognised in profit or loss, and other changes are recognised in equity.

Loans and receivables

Trade receivables, loans, and other receivables that have fixed or determinable payments that are not quoted in an active market are classified as loans and receivables. Loans and receivables are measured at amortised cost using the effective interest method less any impairment. Interest income is recognised by applying the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial.

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Cash and cash equivalents

Cash and cash equivalents comprise cash balances, cash deposits and highly liquid investments with maturities of three months or less, those are readily convertible to known amounts of cash and are subject to an insignificant risk of changes in value.

Impairment of financial assets

Financial assets, other than those at FVTPL, are assessed for indicators of impairment at each balance sheet date. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been impacted. For financial assets carried at amortised cost, the amount of the impairment 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.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables where the carrying amount is reduced through the use of an allowance account. When a trade receivable is uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognised in profit or loss.

With the exception of AFS equity instruments, if, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

In respect of AFS equity securities, any increase in fair value subsequent to an impairment loss is recognised directly in equity.

Derecognition of financial assets

The Group derecognises a financial asset only when the contractual rights to the cash flows from the asset expire; or it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If the Group neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Group recognises its retained interest in the asset and an associated liability for amounts it may have to pay. If the Group retains substantially all the risks and rewards of ownership of a transferred financial asset, the Group continues to recognise the financial asset and also recognises a collateralised borrowing for the proceeds received.

Financial liabilities and equity instruments issued by the Group

Classification as debt or equity

Debt and equity instruments are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangement.

Equity instruments

An equity instrument is any contract that evidences a residual interest in the asset of an entity deducting all of its liabilities. Equity instruments issued by the Group are recorded at the proceeds received, net of direct issue costs.

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Financial guarantee contract liabilities

Financial guarantee contract liabilities are measured initially at their fair values and are subsequently measured at the higher of:

- The amount of the obligation under the contract, as determined in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*; and
- The amount initially recognised less, where appropriate, cumulative amortisation recognised in accordance with the revenue recognition policies set out above.

Financial liabilities

Financial liabilities can be classified as financial liabilities at FVTPL or as other financial liabilities.

Financial liabilities at FVTPL

Financial liabilities are classified as at FVTPL where the financial liability is either held for trading or it is designated as at FVTPL.

A financial liability is classified as held for trading if:

- It has been incurred principally for the purpose of repurchasing in the near future; or
- It is a part of an identified portfolio of financial instruments that the Group manages together and has a recent actual pattern of short-term profit-taking; or
- It is a derivative that is not designated and effective as a hedging instrument.

A financial liability other than a financial liability held for trading may be designated as at FVTPL upon initial recognition if:

- Such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise; or
- The financial liability forms part of a group of financial assets or financial liabilities or both, which is managed and its performance is evaluated on a fair value basis, in accordance with the Group's documented risk management or investment strategy, and information about the grouping is provided internally on that basis; or
- It forms part of a contract containing one or more embedded derivatives, and IAS 39 *Financial Instruments: Recognition and Measurement* permits the entire combined contract (asset or liability) to be designated as at FVTPL.

Financial liabilities at FVTPL are stated at fair value, with any resultant gain or loss recognised in profit or loss. The net gain or loss recognised in profit or loss incorporates any interest paid on the financial liability. Fair value is determined in the manner described in Note 26.

Other financial liabilities

Other financial liabilities, including loans and borrowings, are initially measured at fair value, net of transaction costs.

Other financial liabilities are subsequently measured at amortised cost using the effective interest method, with interest expense recognised on an effective yield basis.

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Effective interest method

The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or, where appropriate, a shorter period.

Derecognition of financial liabilities

The Group derecognises financial liabilities when, and only when, the Group's obligations are discharged, cancelled or they expire.

Employee benefits

Defined contribution plans

All Group's subsidiaries are legally obliged to make defined contributions to the Russian Federation State Pension Fund.

The Group's contributions to the Russian Federation State Pension Fund relating to defined contribution plans are charged to income statement in the period to which they relate.

In the Russian Federation all state social contributions, including contributions to the Russian Federation State Pension Fund, are collected through a unified social tax ("UST") calculated by the application of a regressive rate from 26% to 2% of the annual gross remuneration of each employee. UST is allocated to three state social funds, including the Russian Federation State Pension Fund, where the rate of contributions to that fund vary from 20% to 2%, depending on the annual gross remuneration of each employee.

Contributions to defined contribution retirement benefit plans are recognised as an expense when employees have rendered service.

Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that the Group will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the balance sheet date, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, the receivable is recognised as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

Income tax

Income tax expense is reflected in the consolidated financial statements in accordance with the current tax legislation correspondence. Income tax expense includes current and deferred taxes and is adopted in the consolidated income statement excluding the tax, relevant to the operations, immediately reflected in equity, in the current or any other period. Beginning with the 1st of January, 2009, income tax rate will equal to 20% for all members of the Group.

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Current tax

Current tax currently payable is based on taxable profit for the year. Taxable profit differs from 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 Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted at the balance sheet date.

Deferred tax

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary differences arise from goodwill or from initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and associates, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments and interests are only recognised to the extent that it is probable that there will be sufficient taxable profits against which to utilise the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset realised, based on tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Group expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities on a net basis.

Current and deferred taxes are recognised as an expense or income in the consolidated income statement, except when they relate to items credited or debited directly to equity, in which case the tax is also recognised directly in equity, or they arise from the initial accounting for a business combination. In case of a business combination, the tax effect is taken into account in calculating goodwill or determining the excess of the acquirer's interest in the net fair value of the acquirer's identifiable assets, liabilities and contingent liabilities over the cost.

Dividends declared

Dividends paid to shareholders are determined by the board of directors and declared and approved at the annual shareholders' meeting.

Dividends and related taxation thereon are recognised as a liability in the period in which they have been declared and become legally payable.

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Accumulated profits distributable by the Group's entities are based on the amounts available for distribution in accordance with the applicable legislation of the jurisdictions where each entity operates and as reflected in the statutory financial statements of the individual entities of the Group based on calendar reporting years (years ending 31 December). These amounts may differ significantly from the amounts calculated on the basis of IFRSs.

Related parties

Related parties are those counterparties that represent:

- (a) Enterprises that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under the common control of, the Group. This includes, but is not limited to, holding companies, subsidiaries and fellow subsidiaries;
- (b) Enterprises over which the Group has significant influence and which are neither subsidiaries nor joint ventures of the investor. This includes associates;
- (c) Individuals owning, directly or indirectly, an interest in the voting power of the Group, which gives them significant influence over the Group, and anyone expected to influence, or be influenced by, that person in their dealings with the Group;
- (d) Key management personnel, namely persons with authority and responsibility for planning, directing and controlling the activities of the Group, including directors and officers of the Group and close family members of such individuals; and
- (e) Enterprises in which a substantial interest in the voting power is owned, directly or indirectly, by any person described in (c) or (d) or over which such a person is able to exercise significant influence. This includes enterprises owned by directors, partners or shareholders of the Group and enterprises that have a member of key management in common with the Group.

In considering each possible related-party relationship, attention is paid to the substance of the relationship, and not merely the legal form.

3. KEY SOURCES OF ESTIMATION UNCERTAINTY

In the process of applying the Group's accounting policies, management is required to make judgments, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods of the revision affects both current and future periods.

Key sources of estimation uncertainty

The following are the key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Allowance for trade and other receivables

The allowance for trade and other receivables is based on management's evaluation of the volume of the receivables outstanding, past experience and general economic conditions.

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Useful lives of assets

The useful economic lives of the Group's assets are determined by management at the time the asset is acquired and are regularly reviewed for appropriateness. The Group defines useful lives of its assets in terms of the assets' expected utility to the Group. This judgment is based on the experience of the Group with similar assets. In determining the useful life of an asset, the Group also considers technical and/or commercial obsolescence, appearing in consequence of changes or improvements of the market situation.

Impairment of goodwill

Determining whether goodwill is impaired requires an estimation of the value in use of the cash-generating units to which goodwill has been allocated. The value in use calculation requires the entity to estimate the future cash flows expected to arise from the cash-generating unit and a suitable discount rate in order to calculate present value.

Income tax

The Group is subject to income taxes and other taxes. Significant judgment is required in determining the provision for income taxes due to the complexity of the tax legislation of the Russian Federation. There are many transactions and calculations for which the ultimate tax determination is uncertain. The Group recognises liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax provisions in the period in which such determination is made.

Deferred tax assets are reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. The estimation of that probability includes judgments based on the expected performance. Various factors are considered to assess the probability of the future utilisation of deferred tax assets, including past operating results, operational plan, expiration of tax losses carried forward, and tax planning strategies. If actual results differ from that estimates or if these estimates must be adjusted in future periods, the financial position, results of operations and cash flows may be negatively affected.

Allowance for slow-moving inventory

Allowances for slow-moving inventories are made to reduce excess inventories to their estimated net realizable values, as necessary. A change in customer demand for inventory is the primary indicator for reductions in inventory carrying values. The Group records inventory allowances based on historical experiences with customers, the ability to utilise inventory in other programs, the ability to redistribute inventory back to the suppliers and current and forecasted demand for the inventory.

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4. ADOPTION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS

In the current year, the Group has adopted all of the new and revised Standards and Interpretations issued by the International Accounting Standards Board (the IASB) and the International Financial Reporting Interpretations Committee (the IFRIC) of the IASB that are relevant to its operations and effective for annual reporting periods beginning on 1 January 2008. The adoption of these new and revised Standards and Interpretations has not resulted in changes to the Company's accounting policies.

At the date of authorisation of these financial statements, the following Standards and Interpretations, which may be applicable to the Group were issued but not yet effective:

Standards and Interpretations	Effective for annual periods beginning on or after
IFRS 3 Business Combinations (revised 2008)	1 July 2009
IFRS 5 Non-current Assets Held for Sale and Discontinued Operations	1 July 2009
IFRS 7 Financial Instruments: Disclosures	1 January 2009
IFRS 8 Operating Segments	1 January 2009
IFRS 9 Financial Instruments	1 January 2013
IAS 1 Presentation of Financial Statements (revised)	1 January 2009
IAS 7 Statement of Cash Flows (amendment)	1 January 2010
IAS 16 Property, Plant and Equipment (amendment)	1 January 2009
IAS 17 Leases (amendment)	1 January 2010
IAS 23 Borrowing Costs (revised)	1 January 2009
IAS 27 Consolidated and Separate Financial Statements (revised 2008)	1 July 2009
IAS 28 Investments in Associates (revised 2008)	1 July 2009
IAS 32 Financial Instruments: Presentation (amendment)	1 January 2009
IAS 36 Impairment of Assets (amendment)	1 January 2009
IAS 38 Intangible Assets (amendment)	1 January 2009
IAS 39 Financial Instruments: Recognition and Measurement (amendment)	1 January 2009
IFRIC 14 Prepayments of a Minimum Funding Requirement	1 January 2011
IFRIC 16 Hedges of a Net Investment in a Foreign Operation	1 July 2009
IFRIC 17 Distributions of Non-cash Assets to Owners	1 July 2009
IFRIC 18 Transfers of Assets from Customers	1 July 2009
IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments	1 July 2010

Management anticipates that the adoption of these Standards in future periods will have no material financial impact on the consolidated financial statements of the Group.

5. ACQUISITION OF SUBSIDIARIES

CJSC "Nature Development Institute"

In October 2007 the Group acquired 74.8% of voting shares of CJSC "Nature Development Institute". Initially the accounting for the acquisition of CJSC "Nature Development Institute" has been determined provisionally. In 2008 the fair value of acquired identifiable assets and liabilities has been assessed by the independent appraiser. Resulting fair value adjustments have been determined and provisional amounts have been revised.

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Summarized effect on the consolidated balance sheet is presented below:

	As at 31 December 2007		
	Previous report statements	Adjustments	Recorded amounts
Property, plant and equipment	680,331	1,868	682,199
Goodwill	26,462	2,513	28,975
Minority interest	9,917	471	10,388
Short-term provisions and other payables	88,122	3,910	92,032

Together with evaluation of fair value of assets and liabilities discussed above, the Group assessed the recoverable amount of goodwill associated with acquired business of CJSC "Nature Development Institute" and determined that goodwill was impaired by RUB 20,176 thousand. In assessing the recoverable amount of the business unit discounted cash flow method was applied, with discount factor on the level of 21.42%

The resulting adjusting entries are as follow:

	For the year ended 31 December 2007		
	Previous report statements	Adjustments	Recorded amounts
Impairment of goodwill	-	(20,176)	(20,176)
Profit before income tax	791,785	(20,176)	771,609
Profit for the year	582,059	(20,176)	561,883

The main factor contributing to impairment of cash-generated unit was a change in a market situation, negatively affecting the unit.

Details on acquisition are as follow:

	Fair value on acquisition	Book value on acquisition
Property, plant and equipment		
Inventories	7,409	5,540
Trade and other receivables	17,177	17,309
Cash and cash equivalents	38,766	38,635
Deferred tax liability	1,809	1,609
Trade accounts payables	(756)	(756)
Short-term borrowings	(50,241)	(50,241)
	(700)	(700)
	<u>13,264</u>	<u>11,396</u>
Minority interest	(3,343)	
Goodwill	<u>28,975</u>	
Total consideration satisfied by cash	<u>38,896</u>	
Net cash outflow on acquisition		
Total purchase consideration		<u>38,896</u>
Consideration paid in cash		34,966
Contingent consideration paid in 2008		<u>3,910</u>
		<u>38,896</u>
Less: cash and cash equivalent balances acquired		<u>(1,609)</u>
		<u>37,287</u>

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Goodwill arose on acquisition of as the cost of the combination included a control premium paid to acquire the company. In addition, the consideration paid for the combination effectively included amounts in relation to the expected synergies, revenue growth, future market development, the assembled workforce and future investment plans' fulfillment. These benefits are not recognised separately from goodwill and income on business combination as the future economic benefits arising from them cannot be reliably measured.

LLC "Automation means control"

In the 1st quarter of 2008 the Group acquired 100% of the shares of LLC "Automation means control" from OJSC "TNK-BP", as well as certain items of property, plant and equipment acquired directly from OJSC "TNK-BP".

Details on acquisition are as follow:

	<u>Fair value on acquisition</u>	<u>Book value on acquisition</u>
Property, plant and equipment	1,169	1,169
Other non-current assets	120	120
Inventories	1,928	1,928
Trade and other receivables and other payments	15,931	15,931
Cash and cash equivalents	5,967	5,967
Other current assets	717	717
Deferred tax liability	(19)	(19)
Trade accounts payables	(15,257)	(15,257)
Accrued expenses	-	(6,099)
	<u>11,987</u>	<u>5,088</u>
Value of property, plant and equipment	<u>54,692</u>	
	66,679	
Excess of the fair value of acquired net assets over consideration paid	<u>(7,343)</u>	
Total consideration satisfied by cash	<u>59,336</u>	
Net cash outflow on acquisition		
Consideration paid in cash (in 2007)		59,336
Less: cash and cash equivalent balances acquired		<u>(5,967)</u>
		<u>53,369</u>

Excess of fair value of acquired net assets over cost of consideration paid of RUB 7,343 thousand arose primary due to the Group's competitive position in negotiations and was recognized directly in the income statement.

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Net outflow on acquisition

	31 December 2008	31 December 2007
CJSC "Nature Development Institute"		
Consideration paid in cash		34,986
Contingent consideration paid		(1,609)
Less: cash and cash equivalent balances acquired	3,910	
		59,336
LLC "Automation means control"		
Consideration paid in cash		59,336
Less: cash and cash equivalent balances acquired	(5,967)	
	2,057	92,713

Impact of the acquisition on the results of the Group

Included in the profit for 2007 is RUB 13,593 thousand attributable to the additional business generated by CJSC "Nature Development Institute".

Included in the profit for the year for 2008 is RUB 108,128 thousand attributable to the additional business generated by LLC "Automation means control".

Had these business combinations been effected at 1 January, the revenue of the Group from continuing operations would have been RUB 4,495,918 thousand and RUB 4,358,864 thousand and the profit for the year from continuing operations would have been RUB 286,790 thousand and RUB 560,720 thousand in 2008 and 2007 respectively.

In determining the effect of the acquisitions on the revenue and profit of the Group, the management have made the following assumptions:

- Calculated depreciation and amortisation of plant and equipment acquired on the basis of the fair values arising in the initial accounting for the business combination rather than the carrying amounts recognised in the pre-acquisition financial statements,
- Based borrowing costs on the funding levels, credit ratings and debt/equity position of the Group after the business combination; and
- Excluded takeover defence costs of the acquire as a one-off pre-acquisition transaction.

Movement of goodwill

	31 December 2008	31 December 2007 (restated)
Balance as of 1 January		
Acquisition of CJSC "Nature Development Institute"	8,799	-
Balance as of 31 December	8,799	28,975
Impairment loss recognized in the year		(20,176)
Caring amount	8,799	8,799