

**Open Joint Stock Company
“AK OZNA” and Subsidiaries**

Independent Auditors’ Report

Consolidated Financial Statements
For the Year Ended 31 December 2007

OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

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OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

STATEMENT OF MANAGEMENT’S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007

The following statement, which should be read in conjunction with the independent auditors’ responsibilities stated in the independent auditors’ report set out on pages 2-3, is made with a view to distinguishing the respective responsibilities of management and those of the independent auditors in relation to the consolidated financial statements of the Open Joint Stock Company “AK OZNA” and its subsidiaries (the “Group”).

Management is responsible for the preparation of consolidated financial statements that present fairly the consolidated financial position of the Group at 31 December 2007, the consolidated results of its operations, changes in shareholders’ equity and cash flows for the year then ended, in compliance with International Financial Reporting Standards (“IFRS”).


In preparing the consolidated financial statements, management is responsible for:


- Selecting suitable accounting principles and applying them consistently;
- Making judgments and estimates that are reasonable and prudent;
- Stating whether IFRS have been followed, subject to any material departures disclosed and explained in the consolidated financial statements; and
- Preparing the consolidated financial statements on a going concern basis, unless it is inappropriate to presume that the Group will continue in business for the foreseeable future.

Management is also responsible for:

- Designing, implementing and maintaining an effective and sound system of internal controls throughout the Group;
- Maintaining proper accounting records that disclose, with reasonable accuracy at any time, the financial position of the Group, and which enable them to ensure that the consolidated financial statements of the Group comply with IFRS;
- Maintaining statutory accounting records in compliance with local legislation and accounting standards in the respective jurisdictions in which the Group operates;
- Taking such steps as are reasonably available to them to safeguard the assets of the Group; and
- Preventing and detecting fraud and other irregularities.

The consolidated financial statements for the year ended 31 December 2007 were approved on 28 July 2008 by:


E.V. Mavrin
General Director


N.Yu. Vikhareva
Finance Director

28 July 2008

INDEPENDENT AUDITORS' REPORT

To the Shareholders and Board of Directors of Open Joint Stock Company "AK OZNA":

We have audited the accompanying consolidated financial statements of Open Joint Stock Company "AK OZNA" and its subsidiaries (the "Group"), which comprise the consolidated balance sheet as at 31 December 2007, and the consolidated income statement, statement of changes in shareholders' equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

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. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the 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 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 consolidated financial position of Open Joint Stock Company "AK OZNA" and its subsidiaries as at 31 December 2007 and of its consolidated financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Emphasis of matter

Without qualifying our opinion, we draw attention to note 32 to the consolidated financial statements. The comparative consolidated figures for the year ended 31 December 2006 have been restated.

Deloitte & Touche

Moscow
28 July 2008

OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

CONSOLIDATED INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2007

(in thousand of Russian Rubles, except earnings per share)

	Note	Year ended 31 December 2007	Year ended 31 December 2006 (restated)
REVENUE	8	4,246,557	2,804,620
COST OF SALES	9	<u>(2,877,101)</u>	<u>(2,032,052)</u>
GROSS PROFIT		1,369,456	772,568
Selling, general and administrative expenses	10	(529,305)	(342,996)
Other operating expenses, net		<u>(8,532)</u>	<u>(7,150)</u>
OPERATING PROFIT		831,619	422,422
Interest income		46,499	13,185
Interest expense		(83,803)	(31,644)
Share in profit of associates	12	1,977	652
Donations and social expenses		(4,638)	(4,594)
Other non-operating income, net		<u>131</u>	<u>15,822</u>
PROFIT BEFORE TAXATION		791,785	415,843
TAXATION	21	<u>(209,726)</u>	<u>(111,324)</u>
PROFIT FOR THE YEAR		<u>582,059</u>	<u>304,519</u>
Attributable to:			
Equity holders of the parent		577,392	303,513
Minority interest		<u>4,667</u>	<u>1,006</u>
Earnings per share			
Basic and diluted earnings per share (Russian Rubles)	7	128.22	67.40

The notes on pages 8 to 45 form an integral part of these IFRS consolidated financial statements.

OPEN JOINT STOCK COMPANY "AK OZNA" AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET AS OF 31 DECEMBER 2007 (in thousands of Russian Rubles)

	Note	As of 31 December 2007	As of 31 December 2006 (restated)
ASSETS			
NON-CURRENT ASSETS:			
Property, plant and equipment	11	680,331	524,110
Goodwill	6	26,462	-
Intangible assets		8,750	-
Investments in associates	12	38,761	662
Deferred tax assets	21	4,858	2,910
Other long-term assets		925	-
Total non-current assets		<u>760,087</u>	<u>527,682</u>
CURRENT ASSETS:			
Inventories	14	734,272	596,847
Trade and other receivables	15	999,258	460,421
Value-added tax and other tax receivables	16	120,300	69,804
Short-term investments in securities and other financial assets	17	58,830	210,038
Investment classified as held for sale	13	-	72,832
Cash and cash equivalents	18	35,584	31,129
Total current assets		<u>1,948,244</u>	<u>1,441,071</u>
TOTAL ASSETS		<u>2,708,331</u>	<u>1,968,753</u>
SHAREHOLDERS' EQUITY AND LIABILITIES			
SHAREHOLDERS' EQUITY:			
Share capital	19	49,067	49,067
Retained earnings		1,282,126	875,776
Equity attributable to equity holders of the parent		<u>1,331,193</u>	<u>924,843</u>
Minority interest		9,917	2,291
Total shareholders' equity		<u>1,341,110</u>	<u>927,134</u>
NON-CURRENT LIABILITIES:			
Long-term borrowings	20	-	20,072
Deferred tax liability	21	79,439	88,038
Total non-current liabilities		<u>79,439</u>	<u>108,110</u>
CURRENT LIABILITIES:			
Trade accounts payables	22	134,260	48,861
Advances received		133,434	275,330
Taxes payable	23	29,624	20,828
Short-term borrowings	24	902,342	536,383
Accruals and other payables	25	88,122	52,107
Total current liabilities		<u>1,287,782</u>	<u>933,509</u>
TOTAL SHAREHOLDERS' EQUITY AND LIABILITIES		<u>2,708,331</u>	<u>1,968,753</u>

The notes on pages 8 to 45 form an integral part of these IFRS consolidated financial statements.

OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY FOR THE YEAR ENDED 31 DECEMBER 2007 (in thousands of Russian Rubles)

	Note	Share capital	Retained earnings (restated)	Attributable to equity holders of the parent (restated)	Minority interest	Total (restated)
Balance as of 1 January 2006, as previously reported		49,067	692,854	741,921	1,285	743,206
Restatement	32	-	5,561	5,561	-	5,561
Balance as of 1 January 2006, as restated		49,067	698,415	747,482	1,285	748,767
Profit for the year, as restated	32	-	303,513	303,513	1,006	304,519
Total recognized income and expense		-	303,513	303,513	1,006	304,519
Dividends		-	(126,152)	(126,152)	-	(126,152)
Balance as of 1 January 2007		49,067	875,776	924,843	2,291	927,134
Profit for the year		-	577,392	577,392	4,667	582,059
Total recognized income and expense		-	577,392	577,392	4,667	582,059
Minority interest acquired during acquisition of subsidiary	6	-	-	-	2,872	2,872
Increase in minority interest due disposal of the subsidiary		-	-	-	87	87
Dividends		-	(171,042)	(171,042)	-	(171,042)
Balance as of 31 December 2007		49,067	1,282,126	1,331,193	9,917	1,341,110

The notes on pages 8 to 45 form an integral part of these IFRS consolidated financial statements.

OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2007 (in thousands of Russian Rubles)

	Note	Year ended 31 December 2007	Year ended 31 December 2006 (restated)
OPERATING ACTIVITIES:			
Cash flows from operating activities	26	263,552	80,230
Income tax paid		(261,287)	(110,698)
Interest paid		(84,092)	(23,461)
Net cash used in operating activities		(81,827)	(53,929)
INVESTING ACTIVITIES:			
Interest received		30,051	13,185
Purchase of property, plant and equipment		(203,704)	(47,764)
Proceeds on disposal of property, plant and equipment		6,695	2,229
Purchase of investments in subsidiary	6	(33,377)	-
Purchase of investments in associate	12	(36,122)	-
Purchase of intangible and other assets		(9,675)	-
Purchase of securities and other financial assets		(2,174,309)	(487,996)
Proceeds on disposal of securities and other financial assets		2,331,779	309,776
Net cash used in investing activities		(88,662)	(210,570)
FINANCING ACTIVITIES:			
Proceeds from borrowings		2,703,210	2,433,624
Repayment of borrowings		(2,357,135)	(2,079,943)
Dividends paid		(171,131)	(126,152)
Net cash from financing activities		174,944	227,529
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS		4,455	(36,970)
CASH AND CASH EQUIVALENTS, beginning of year	18	31,129	68,099
CASH AND CASH EQUIVALENTS, end of year	18	35,584	31,129

The notes on pages 8 to 45 form an integral part of these IFRS consolidated financial statements.

OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (in thousand of Russian Rubles)

1. NATURE OF THE BUSINESS

Open Joint Stock Company “AK OZNA” (the “Company”) was incorporated in 1993. The head office of the Company and its production plant are located at 60 Severnaya St., Oktyabrsky, the Republic of Bashkortostan, 452600, Russian Federation.

The principal activities of the Company and its subsidiaries (“the Group”) are the production and sale of equipment for the oil and gas industry. The Group produces a wide variety of oil extracting and transportation equipment as well as heating and hot water supply equipment. The Group is carrying out the whole cycle of oil and gas equipment production, from the engineering stage to third party installations testing of and start-up activities.

The principal activities and the significant subsidiaries of the Group are:

Company name	Place of incorporation and operation	Activity	Effective interest held as at:	
			31 December 2007	31 December 2006
OJSC “AK OZNA”	Bashkortostan	Holding Company. Production and sales of oil and gas equipment		
LLC “OZNA Service”	Bashkortostan	Servicing and installation of equipment	100.00%	100.00%
LLC “OZNA -West Siberia”	Moscow	Sales of oil and gas equipment in North-West region	51.00%	51.00%
LLC “Avtofirma OZNA”	Bashkortostan	Transportation services, and financial services	-	100.00%
LLC Hotel “Tonus”	Bashkortostan	Hotel	100.00%	100.00%
LLC “Center of real estate management”	Bashkortostan	Management of social facilities	99.44%	99.44%
LLC “OZNA-Engineering”	Bashkortostan	Production and sale of hi-tech oil and gas equipment	100.00%	100.00%
CJSC “Nature Development Institute”	Nizhnevartovsk	Research and development works for new oil fields (acquired in October 2007)	74.80%	-
LLC “OZNA-Finance”	Bashkortostan	Financial services	100.00%	100.00%

All the above companies are incorporated in the Russian Federation.

In December 2007, the Group disposed of subsidiary LLC “Avtofirma OZNA”.

During 2007 shareholders of the Group created the company LLC “OZNA-Management”. All functions of Group management were transferred to newly created company.

The number of employees of the Group at 31 December 2007 and at 31 December 2006 was 3,001 and 2,963 employees respectively.

OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (in thousand of Russian Rubles)

2. BASIS OF PRESENTATION

The consolidated financial statements of the Group 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.

Functional and presentation currencies

The functional currency of OJCS AK “OZNA” and each of its subsidiaries is the Russian Ruble (“RUR”).

In 2007, management considers that the Russian Ruble is a more relevant presentation currency for users of the consolidated financial statements of the Group. The presentation currency of the consolidated financial statements is the Russian Rubles.

The prior year consolidated financial statements were presented in US Dollars.

For the 2006 consolidated financial statements, the translation from RUR (functional currency of the Group) into US Dollar (presentation currency) was performed in accordance with the requirements of *IAS 21 The Effects of Changes in Foreign Exchange Rates*, as described below:

- All assets and liabilities, both monetary and non-monetary, were translated at closing exchange rates at the dates of each consolidated balance sheet presented;
- All income and expenses in each consolidated income statement were translated at the average exchange rates for the years presented;
- All resulting exchange differences were included in equity and presented separately as an effect of translation into presentation currency; and
- In the consolidated statement of cash flows, cash balances at the beginning and end of each year presented were translated at exchange rates at the respective dates.

To present comparatives for the year ended 31 December 2006 in the presentation currency of the current year report, the following exchange rates were used:

	31 December 2006
Year-end rate	
RUR/1 US Dollar	26.3311
Average rate for the year ended	
RUR/1 US Dollar	27.1920

OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (in thousand of Russian Rubles)

3. ADOPTION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS

In the current year, the Group has adopted all new International Financial Reporting Standards and interpretations issued by International Financial Interpretation Reporting Interpretation Committee that are mandatory for adoption in the annual periods beginning on or after 1 January 2007. The impact of the adoption of these standards and interpretations has been to expand the disclosures provided in these consolidated financial statements.

The principal effect of these changes are as follows:

IAS 1 Presentation of Financial Statements (amendment)

This amendment requires the Group to provide new disclosures to enable users of the consolidated financial statements to evaluate the Group's principle objectives; policies and procedures for managing capital (Note 29).

IFRS 7 Financial Instruments: Disclosures

This standard introduces new disclosures that enable users of the consolidated financial statements to evaluate the significance of the Group's financial instruments and the nature and extent of risks arising from those financial instruments. The new or expanded disclosures are included in the consolidated financial statements.

The following interpretations issued by IFRIC are also effective for the current period *IFRIC 8 Scope of IFRS 2; IFRIC 9 Reassessment of Embedded Derivatives; and IFRIC 10 Interim Financial Reporting and Impairment*. The adoption of these interpretations has not led to any changes in the Group's accounting policies or disclosures provided in the consolidated financial statements.

Early adoption of Standards and Interpretations

In addition, the Group has elected to adopt the following standard in advance of its effective date:

IAS 23 (Revised) Borrowing Costs (effective for annual periods on or after 1 January 2009).

The revisions to IAS 23 have had no impact on the Group's accounting policies. The principal change to the Standard, which was to eliminate the previously available option to expense all borrowing costs when incurred, has no impact on these consolidated financial statements because it has always been the Group's accounting policy to capitalise the borrowing costs incurred on qualifying assets.

OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (in thousand of Russian Rubles)

Standards and interpretations in issue but not yet adopted

At the date of authorisation of these consolidated financial statements, other than the Standards adopted by the Group in advance of their effective dates (as described above), the following Interpretations were in issue but not yet effective:

Standards and Interpretations	Effective for annual periods beginning on or after
IAS 1 Presentation of Financial Statements (amendment)	1 January 2009
IAS 27 Consolidated and Separate Financial Statements (amendment due to revision of IFRS 3)	1 July 2009
IAS 28 Investments in Associates (amendments due to revision of IFRS 3)	1 July 2009
IAS 31 Interests in Joint Ventures (amendments due to revision of IFRS 3)	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
IAS 40 Investment Property (amendment)	1 January 2009
IAS 41 Agriculture (amendment)	1 January 2009
IFRS 2 Share-based Payment (amendment)	1 January 2009
IFRS 3 Business Combinations (revised on applying the acquisition method)	1 July 2009
IFRS 8 Operating Segments	1 January 2009
IFRIC 11 IFRS 2 – Group and Treasury Share Transactions	1 March 2007
IFRIC 12 Service Concession Arrangements	1 January 2008
IFRIC 13 Customer Loyalty Programmes	1 July 2008
IFRIC 14 IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction	1 January 2008

The impact of adoption of these standards and interpretations in the preparation of the consolidated financial statements in future periods is currently being assessed by management; however no material effect on the Group’s accounting policies is anticipated.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of consolidation

The consolidated financial statements incorporate the financial statements of OJSC “AK 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.

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 “AK 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 unrealised profits or losses arising from intra-group transactions, are eliminated on consolidation.

OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (in thousand of Russian Rubles)

Minority interests in the net assets (excluding goodwill) of consolidated subsidiaries are identified separately from the Group's equity therein. 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 acquiree, plus any costs directly attributable to the business combination. The acquiree'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.

The interest of minority shareholders in the acquiree is initially measured at the minority's proportion of the net fair value of the assets, liabilities and contingent liabilities recognised.

Any differences arising from acquisition of additional non-controlling interests in subsidiaries between carrying values of net assets attributable to acquired interests and consideration paid are either added to additional paid-in-capital, if positive, or charged to retained earnings, if negative.

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 not recognised.

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.

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

OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (in thousand of Russian Rubles)

Goodwill

Goodwill arising on the acquisition of a subsidiary or jointly controlled entity 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 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.

OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (in thousand of Russian Rubles)

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.

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, which is the rate that exactly discounts the estimated future cash receipts, through the expected life of the financial asset, to that assets net carrying amount.

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

Segmental reporting

The Group operates in one business segment and one geographical segment: production and sales of finished goods in the Russian Federation.

At present, revenue from rendering of services comprises less than 2% of total sales; therefore management of the Group considers that it is not practical to disclose segment information about business segments.

Revenue from export comprises less than 10% of total sales; therefore management of the Group considers that it is not practical to disclose segment information about geographical segments.

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.

OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (in thousand of Russian Rubles)

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 deemed cost. 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 that extend the useful lives of the assets or increase their revenue generating capacity. 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. The estimated useful lives, residual values and depreciation method are reviewed at each year end, with the effect of any changes in estimate accounted for on a prospective basis.

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

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

Properties in the course of construction for production, rental or administrative purposes, or for purposes not yet determined, are carried at cost, less any recognised impairment loss. Cost includes, for qualifying assets, borrowing costs capitalised in accordance with the Group's accounting policy. Depreciation of these assets, on the same basis as other property assets, commences when the assets are put into operation.

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. 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.

OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (in thousand of Russian Rubles)

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.

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.

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.

OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 *(in thousand of Russian Rubles)*

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.

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 28.

OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (in thousand of Russian Rubles)

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.

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.

OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (in thousand of Russian Rubles)

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.

OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (in thousand of Russian Rubles)

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 are classified into the following specified categories:

- Financial liabilities at FVTPL; and
- 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 28.

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.

OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (in thousand of Russian Rubles)

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.

Income tax

Income tax expense represents the sum of the tax currently payable and deferred tax.

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.

OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (in thousand of Russian Rubles)

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.

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.

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.

OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (in thousand of Russian Rubles)

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.

5. CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

In the process of applying the Group’s accounting policies, management is required to make judgements, 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.

OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (in thousand of Russian Rubles)

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.

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 in different jurisdictions of the Russian Federation and abroad. 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.

As of 31 December 2007 inventory balance included materials with cost of 24,702 thousand rubles that have no movement during the year. Management considers that no allowance should be created for these materials as they will be used in production or sell at the amount not less than cost.

OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (in thousand of Russian Rubles)

6. ACQUISITION AND DISPOSAL OF SUBSIDIARIES

In October 2007, the Group acquired 74.8% of voting shares in CJSC “Nature Development Institute” from Mr. Krupin S.N., Mr. Hurshudov A.G. and Mr. Melnikov V.P. Details of acquisition are as follows:

	Carrying amount at the date of acquisition
Property, plant and equipment	5,540
Inventories	17,309
Trade and other receivables and prepayments	38,635
Cash and cash equivalents	1,609
Deferred tax liability	(756)
Trade and other payables	(50,241)
Short-term borrowings	(700)
	<u>11,396</u>
Minority interest	(2,872)
Goodwill	<u>26,462</u>
Total consideration satisfied by cash	<u>34,986</u>
Net cash outflow arising from acquisition	
Settled in cash	(34,986)
Cash acquired with the net assets of subsidiary	<u>1,609</u>
Net cash outflow on acquisition	<u>(33,377)</u>

The initial accounting for the acquisition of CJSC “Nature Development Institute” has only been provisionally determined at the balance sheet date. For tax purposes, the tax values of Company’s assets are required to be reset based on market values and other factors. At the date of finalisation of these consolidated financial statements, the necessary market valuations and other calculations had not been finalised and the adjustments to deferred tax liabilities and goodwill noted above have therefore only been provisionally determined based on the managements’ best estimate of the likely tax values. The market valuations obtained for tax purposes may also impact the recognised fair values of the other assets acquired as part of the business combination.

Goodwill arose in the business combination because the cost of the combination included a control premium paid to acquire this company. In addition, the consideration paid effectively included amounts in relation to the benefit of expected synergies, revenue growth, future market development, the assembled workforce and future investment projects from the combination. These benefits are not recognised separately from goodwill as the future economic benefits arising from them cannot be reliably measured. The purchased subsidiary contributed 55,937 thousand Russian Rubles to the Group’s revenue and 13,593 thousand Russian Rubles to the Group’s profit before tax for the period from the date of acquisition to the balance sheet date.

As of 31 December 2007, the Group assessed the recoverable amount of goodwill, and determined that no goodwill associated with the Group’s operations was impaired.

OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (in thousand of Russian Rubles)

Prior to acquisition, the acquired entity did not prepare financial statements in accordance with IFRS. Hence it was not practicable to determine the carrying amounts of the acquired assets, liabilities and contingent liabilities in accordance with IFRS immediately before the acquisition, and such information is not presented in the consolidated financial statements of the Group.

In December 2007, the decision to withdrawal from LLC “Avtofirma OZNA” was taken. The net assets disposed are not material for separate disclosure in the consolidated financial statements of the Group. Accounts receivable 79,920 thousand Russian Rubles were recognised as a result of this transaction (Note 15).

7. EARNINGS PER SHARE

Basic and diluted earnings per share for the years ended 31 December 2007 and 2006 have been calculated on the basis of the net profit for the year and the weighted average number of common shares in issue during the year.

The calculation of basic and fully diluted earnings per share is based on the following information:

	Year ended	
	31 December 2007	31 December 2006 (restated)
Profit for the year attributable to equity holders of the parent	577,392	303,513
Weighted average number of shares (in shares)	4,503,297	4,503,297
Basic and diluted earnings per share (Russian Rubles)	128.22	67.40

8. REVENUE

Revenue for the years ended 31 December 2007 and 2006 consisted of the following:

By product	Year ended	
	31 December 2007	31 December 2006
Bush block pump stations	1,377,658	819,235
Measuring stations	1,303,413	750,786
Blocks	548,717	267,790
Oil terminals	399,926	354,661
Spare parts	392,388	428,883
Sales of services	103,309	65,849
Hotel services	29,898	24,542
Other products	91,248	92,874
Total	4,246,557	2,804,620

OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (in thousand of Russian Rubles)

	Year ended	
	31 December 2007	31 December 2006
By destination		
Russian Federation	3,824,110	2,547,550
Ukraine	232,720	699
Kazakhstan	183,144	256,364
Other destinations	6,583	7
Total	4,246,557	2,804,620

Certain reclassifications of prior year amounts have been made to conform with the current year presentation.

9. COST OF SALES

Cost of sales for the years ended 31 December 2007 and 2006 consisted of the following:

	Year ended	
	31 December 2007	31 December 2006 (restated)
Cost of production		
Raw materials	2,194,557	1,438,264
Payroll and unified social tax	444,888	296,074
Utilities	41,507	32,269
Depreciation of property, plant and equipment	35,682	25,346
Subcontractors	26,991	-
Repairs and maintenance	1,753	2,256
Other	135,777	63,695
Increase in inventories	(85,205)	(4,078)
Cost of goods resold	81,151	178,226
Total	2,877,101	2,032,052

Certain reclassifications of prior year amounts have been made to conform with the current year presentation.

OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (in thousand of Russian Rubles)

10. SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses for the years ended 31 December 2007 and 2006 consisted of the following:

	Year ended	
	31 December 2007	31 December 2006 (restated)
Payroll and unified social taxes	243,498	149,736
Services of governance	78,049	-
Transportation expenses	47,292	36,673
Consulting and audit fees	18,638	7,748
Rent	14,952	3,072
Raw materials	11,385	29,414
Depreciation	7,856	11,530
Utilities	6,923	4,921
Bank services	6,505	4,372
Warranty expenses	6,235	2,664
Business trip expenses	6,066	17,154
Taxes other than income tax	4,371	5,592
Repairs and maintenance	3,816	3,552
Change in allowances for doubtful receivables	3,133	(3,275)
Change in allowances for slow-moving inventories	3,130	(5,394)
Insurance expenses	3,016	1,791
Other expenses	64,440	73,446
Total	529,305	342,996

Certain reclassifications of prior year amounts have been made to conform with the current year presentation.

OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (in thousand of Russian Rubles)

11. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment as of 31 December 2007 and 2006 were as follows:

	Buildings and land	Machinery and equipment	Other assets	Construction in progress	Total
Cost					
As of 1 January 2006	280,113	236,095	16,139	31,186	563,533
Additions	2,865	26,454	11,893	9,304	50,516
Transfers from construction in progress	18,070	383	-	(18,453)	-
Disposals	-	(2,672)	(4,977)	(15,220)	(22,869)
As of 31 December 2006	301,048	260,260	23,055	6,817	591,180
Additions	32,506	33,911	17,670	119,617	203,704
Acquired on acquisition of subsidiary	117	701	4,722	-	5,540
Transfers from construction in progress	44,698	1,730	-	(46,428)	-
Disposals	(788)	(3,679)	(5,394)	(920)	(10,781)
As of 31 December 2007	377,581	292,923	40,053	79,086	789,643
Accumulated depreciation					
As of 1 January 2006	(7,304)	(22,770)	(2,163)	-	(32,237)
Charge for the year, as restated (Note 32)	(7,494)	(26,930)	(2,452)	-	(36,876)
Eliminated on disposals	-	473	1,570	-	2,043
As of 31 December 2006, as restated	(14,798)	(49,227)	(3,045)	-	(67,070)
Charge for the year	(8,006)	(32,559)	(2,973)	-	(43,538)
Eliminated on disposals	15	1,250	31	-	1,296
As of 31 December 2007	(22,789)	(80,536)	(5,987)	-	(109,312)
Net Book Value					
As of 31 December 2006, as restated	286,250	211,033	20,010	6,817	524,110
As of 31 December 2007	354,792	212,387	34,066	79,086	680,331

As of 31 December 2007, construction in progress included 26,716 thousand Russian Rubles (2006: nil) of advances paid for property, plant and equipment. As of 31 December 2007, property, plant and equipment with a carrying amount of 263,270 thousand Russian Rubles (2006: 10,727) has been pledged as security for certain borrowings granted to the Group (Notes 20 and 24).

OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (in thousand of Russian Rubles)

12. INVESTMENTS IN ASSOCIATES

Investments in associates as of 31 December 2007 and 2006 consisted of the following:

	<u>LCC “OZNA Imstalcon”</u>	<u>LLC “OZNA- Neftegazmash”</u>	<u>Total</u>
Group’s share in net assets	10	-	10
Group’s share in profit for the year	<u>652</u>	<u>-</u>	<u>652</u>
Carrying value as of 31 December 2006	<u>662</u>	<u>-</u>	<u>662</u>
Acquisition of associate	-	36,122	36,122
Excess of Group’s interest in net assets acquired over consideration paid on acquisition of associate	-	(513)	(513)
Group’s share in profit for the year	<u>2,078</u>	<u>412</u>	<u>2,490</u>
Carrying value as of 31 December 2007	<u>2,740</u>	<u>36,021</u>	<u>38,761</u>

Details of the Group’s significant associates as at 31 December 2007 were as follows:

Name of associate	Country	Date of acquisition	Principal activity	Ownership, %	
				31 December 2007	31 December 2006
LLC “OZNA-Neftegazmash”	Russian Federation	September 2007	Rent of production premises	30.5%	-
LCC “OZNA Imstalcon”	Kazakhstan	March 2005	Post sales finished goods maintenance	49%	49%

Summarised financial information in respect of LLC “OZNA-Neftegazmash” is presented below:

	<u>31 December 2007</u>
Total assets	122,632
Total liabilities	<u>4,530</u>
Net assets	<u>118,102</u>
Group’s share of associate’s net asset	<u>36,021</u>

OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (in thousand of Russian Rubles)

13. INVESTMENT CLASSIFIED AS HELD FOR SALE

The Group acquired 47.93% of voting shares in OJSC “InvestCapitalBank” in December 2005.

In 2006, the Group’s management decided to sell this investment. As of 31 December 2006, the assets were expected to be sold within twelve months and were classified as current assets held for sale in the balance sheet as of that date.

During May 2007, the investment was sold for a total cash consideration of 72,186 thousand Russian Rubles and loss at the amount of 646 thousand Russian Rubles was recognised in the consolidated income statement.

14. INVENTORIES

Inventory balances as of 31 December 2007 and 2006 were as follows:

	<u>31 December 2007</u>	<u>31 December 2006</u>
Raw materials, including:		
Armature parts	176,223	149,403
Metal	92,312	70,462
Electronic parts	35,871	32,256
Construction materials	37,067	-
Other	107,032	149,771
Less: allowance for slow-moving inventories	<u>(3,894)</u>	<u>(764)</u>
Total raw materials	444,611	401,128
Work in progress	132,805	109,353
Finished goods	149,655	76,781
Goods for resale	<u>7,201</u>	<u>9,585</u>
Total	<u>734,272</u>	<u>596,847</u>

As of 31 December 2007, raw materials and finished goods with a carrying amount of 149,949 thousand Russian Rubles (2006: nil) were pledged as security for short-term borrowings granted to the Group (Note 24).

15. TRADE AND OTHER RECEIVABLES

Trade and other accounts receivable as of 31 December 2007 and 2006 were as follows:

	<u>31 December 2007</u>	<u>31 December 2006</u>
Trade accounts receivable from third parties	538,093	188,011
Trade accounts receivable from related parties	1,784	-
Advances paid to third parties	381,352	257,229
Advances paid to related parties	301	-
Other receivables and prepayments	9,067	23,307
Other receivables for sales of subsidiary	79,920	-
Less: allowance for doubtful receivables	<u>(11,259)</u>	<u>(8,126)</u>
Total	<u>999,258</u>	<u>460,421</u>

OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (in thousand of Russian Rubles)

The average credit period for the Group’s customers is 120 days. During this period, no interest is charged on the outstanding balances. Thereafter, also no interest is charged on the outstanding balance. The Group has provided fully for all receivables over 365 days because historical experience is such that receivables that are past due beyond 365 days are generally not recoverable. Trade receivables and other receivables between 120 and 365 days are provided for based on estimated irrecoverable amounts, determined by reference to past experience and are regularly reassessed based on the facts and circumstances existing as of each reporting date.

Before accepting any new customer, the Group uses an internal credit system to assess the potential customer’s credit quality. Of the trade receivables balance at the end of the year, the Group’s five largest customers (individually exceeding 2.2% of the total balance) represent 39% (2006: 19.7%) of the outstanding balance.

The following summary shows the outstanding balances of the top five counterparties at the respective balance sheet dates:

	<u>Customer location</u>	<u>31 December 2007</u>	<u>31 December 2006</u>
CJSC “Vankorneft”	Krasnoyarsk	178,135	-
LLC “UNG – service”	Nefteugansk	91,441	6,613
OJSC “Gazprom neft”	St. Petersburg	74,413	-
OJSC “Surgutneftegaz”	Surgut	27,267	846
OJSC “NK Rosneft”	Moscow	22,100	83,433
Total		<u>393,356</u>	<u>90,892</u>

Included in the Group’s receivable balance are debtors with a carrying amount of 293,162 thousand rubles (2006: 134,269) which are past due at the respective reporting date and which the Group still considers recoverable (i.e. not impaired). The Group does not hold any collateral over these outstanding balances. The weighted average age of these receivables is less than 150 days (2006: 90 days). No credit limits are set for these customers.

Ageing of past due but not impaired trade and other receivables:

	<u>31 December 2007</u>	<u>31 December 2006</u>
less than 30 days	106,363	48,715
30-90 days	73,052	33,458
90-180 days	53,895	24,684
180-360 days	56,834	26,030
Thereafter	3,018	1,382
Total	<u>293,162</u>	<u>134,269</u>

OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (in thousand of Russian Rubles)

Movement in allowance for doubtful trade and other receivables:

	<u>31 December 2007</u>	<u>31 December 2006</u>
Balance at the beginning of the year	8,126	11,401
Recognised in the income statement	18,980	-
Amounts written-off as uncollected	(3,789)	-
Amount recovered during the year	(12,058)	(3,275)
Balance at the end of the year	<u>11,259</u>	<u>8,126</u>

Ageing of impaired trade and other receivables:

	<u>31 December 2007</u>	<u>31 December 2006</u>
less than 30 days	-	-
30-90 days	-	-
90-180 days	-	-
180-360 days	-	-
Thereafter	11,259	8,126
Total	<u>11,259</u>	<u>8,126</u>

16. VALUE-ADDED TAX AND OTHER TAX RECEIVABLES

Value added tax (“VAT”) and other taxes receivable as of 31 December 2007 and 2006 consisted of the following:

	<u>31 December 2007</u>	<u>31 December 2006</u>
VAT reimbursable	56,995	45,869
Income tax receivable	52,826	3,761
Other taxes receivable	10,479	20,174
Total	<u>120,300</u>	<u>69,804</u>

Certain reclassifications of prior year amounts have been made to conform with the current year presentation.

OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (in thousand of Russian Rubles)

17. SHORT-TERM INVESTMENTS IN SECURITIES AND OTHER FINANCIAL ASSETS

Short-term investments in securities and other financial assets as of 31 December 2007 and 2006 consisted of the following:

	<u>31 December 2007</u>	<u>31 December 2006</u>
Available-for-sale investments carried at fair value		
Redeemable notes from third parties ⁽ⁱ⁾	963	60,298
Redeemable notes from related parties	3,000	1,475
	<u>3,963</u>	<u>61,773</u>
Loans given to third parties	11,895	-
Loans given to related parties ⁽ⁱⁱ⁾	42,972	45,263
	<u> </u>	<u> </u>
Bank deposits over 90 less 365 days ⁽ⁱⁱⁱ⁾	-	103,002
	<u> </u>	<u> </u>
Total	<u>58,830</u>	<u>210,038</u>

(i) At 31 December 2006, the Group held non-listed redeemable notes from Brokage Company “Region” returning 11% per annum. The notes were redeemable at par value on 31 January 2007.

(ii) The Group has provided several of its related entity with short-term loans at rates comparable to the average commercial rate of interest.

(iii) Bank deposits at 31 December 2006 mainly represent deposits for 120 days with OJSC “InvestCapital Bank” with 11.25% interest rate.

18. CASH AND CASH EQUIVALENTS

Cash and cash equivalents as at 31 December 2007 and 2006 consisted of the following:

	<u>31 December 2007</u>	<u>31 December 2006</u>
Cash in banks, in RUR	35,379	31,092
Cash in banks, in USD	15	17
Bank deposits	-	2
Cash in hand	190	18
	<u> </u>	<u> </u>
Total	<u>35,584</u>	<u>31,129</u>

Certain reclassifications of prior year amounts have been made to conform with the current year presentation.

OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (in thousand of Russian Rubles)

19. SHARE CAPITAL

The share capital of the Group as of 31 December 2007 and 2006 consists of 4,503,297 authorized, issued and fully paid ordinary shares with a par value of 1 Russian Ruble.

As of 31 December 2007, the shareholders of the Group are represented by:

Shareholder	31 December 2007
Marat Marsovich Akhmetshin	29.22%
Marat Familyevich Fattakhov	29.22%
Artur Valeryevich Khazigaleev	27.56%
Erich Hackstock	9.50%
Alexander Vladimirovich Ashihmin	4.50%
Total	100.00%

As of 31 December 2006, the shareholders of the Group are represented by:

Shareholder	31 December 2006
Marat Marsovich Akhmetshin	28.30%
Marat Familyevich Fattakhov	28.30%
Artur Valeryevich Khazigaleev	28.30%
CJSC “Depositarno kliringovaya Kompaniya”	10.00%
Other legal entities and individuals	5.10%
Total	100.00%

The holders of ordinary shares have voting rights but no guarantee of dividends. Ordinary shareholders are allowed one vote per share. Distributable profits are determined on the basis of profits reported in the statutory financial statements of the Company. These profits differ from profits recorded under IFRS.

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

In 2007, the shareholders of the Group approved dividends of 171,042 thousand Russian Rubles (38 Russian Rubles per share) for the first half of the year 2007. These dividends were paid during 2007.

20. LONG-TERM BORROWINGS

Long-term borrowings as of 31 December 2006 consisted of the following:

	Denominated in currency	Maturity date	Interest rate	31 December 2006
OJSC “Sberbank RF”	RUR	April-08	13.0%	20,072
				20,072

At 31 December 2006 long-term bank borrowing was secured by property, plant and equipment with a carrying value of 3,028 thousand Russian Rubles (Note 11).

OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (in thousand of Russian Rubles)

21. INCOME TAX

The Group’s provision for income tax for the year ended 31 December 2007 and 2006 was as follows:

	Year ended 31 December 2007	Year ended 31 December 2006
Current tax expense	221,029	116,822
Deferred tax benefit	(11,303)	(5,498)
Total	209,726	111,324

Deferred taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes.

The movements in the Group’s deferred tax position were as follows:

	31 December 2007	31 December 2006
Net liability at beginning of the year	85,128	90,626
Benefit for the year	(11,303)	(5,498)
Deferred tax liability assumed on acquisition of subsidiary	756	-
Net liability at end of the year	74,581	85,128

The tax effect of the major temporary differences that gave rise to the deferred tax assets and liabilities as at 31 December 2007 and 2006 is presented below:

	31 December 2007	31 December 2006
Deferred tax assets		
Allowance for doubtful receivables	2,702	1,950
Provision for slow-moving inventory	935	183
Accrual of audit, consulting and other professional services	1,221	777
Total	4,858	2,910
Deferred tax liabilities		
Difference in depreciable value of property, plant and equipment	79,439	87,011
Other adjustments	-	1,027
Total	79,439	88,038
Net deferred tax liability	74,581	85,128

OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (in thousand of Russian Rubles)

The statutory tax rate effective in the Russian Federation was 24% in 2007 and 2006. The taxation charge recorded in the consolidated income statement differs from that which would be obtained by applying the statutory income tax rate to the net profit before income tax. Below is a reconciliation of theoretical income tax at 24% to the actual expense recorded in the Group’s consolidated income statement:

	Year ended 31 December 2007	Year ended 31 December 2006
Profit before taxation	791,785	415,843
Theoretical income tax at statutory rate of 24%	190,028	99,802
Adjustments due to:		
Tax effect of expenses that are not deductible in determining taxable profit	19,698	11,522
Income tax expense	209,726	111,324

22. TRADE ACCOUNTS PAYABLES

Trade payables as of 31 December 2007 and 2006 consisted of the following:

	31 December 2007	31 December 2006
Trade payables to third parties	93,999	47,634
Trade payables to related parties	40,261	1,227
Total	134,260	48,861

The average credit period for the Group on purchase of majority of inventories and on substantial portion of services on the territory of the Russian Federation is 11 days. No interest charge on the outstanding balance for trade and other payables during credit period.

The table below summarises the maturity profile of the Group’s trade payables and payables for property, plant and equipment as at 31 December 2007 and 2006, based on contractual undiscounted payments:

	31 December 2007	31 December 2006
Past due	38,752	13,960
Due within three months	81,820	29,470
Due from three to six months	12,384	4,961
Due from six months to twelve months	1,304	470
Total	134,260	48,861

OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (in thousand of Russian Rubles)

23. TAXES PAYABLE

Taxes payable as of 31 December 2007 and 2006 consisted of the following:

	<u>31 December 2007</u>	<u>31 December 2006</u>
Current income tax	12,105	3,581
Unified social tax	10,542	7,162
Personal income tax	4,852	4,845
Property tax	1,014	658
Value-added tax	183	3,186
Other	928	1,396
	<u><u>29,624</u></u>	<u><u>20,828</u></u>

Certain reclassifications of prior year amounts have been made to conform with the current year presentation.

24. SHORT-TERM BORROWINGS

Short-term borrowings as at 31 December 2007 and 2006 consisted of the following:

	<u>Denominated in currency</u>	<u>Interest Rate</u>	<u>31 December 2007</u>	<u>31 December 2006</u>
Bonds	RUR	10.5%	158,044	502,811
OJSC “Sberbank RF”	RUR	8%-13%	437,821	33,572
CJSC “UniCredit Bank”	RUR	9.93%	205,110	-
LLC “Avtofirma OZNA”	RUR	10%	78,550	-
LLC “Interprom”	RUR	29.3%	21,217	-
OJSC “Bank of Khanty-Mansiysk”	RUR	13%	1,600	-
Total			<u><u>902,342</u></u>	<u><u>536,383</u></u>

The Group issued bonds on 12 December 2006. The issue was at a nominal value of RUR 1 thousand per bond. Bonds mature in 3 years. Bonds are callable at nominal value in one year. During 2007 bonds for a total amount of 339,787 thousand Russian Rubles were callable. The coupon is payable twice per year.

At 31 December 2007, property, plant and equipment with a carrying amount of 263,270 thousand Russian Rubles was pledged as security for short-term borrowings granted to the Group (Note 11).

At 31 December 2006, property, plant and equipment with a carrying amount of 7,699 thousand Russian Rubles was pledged as security for short-term borrowings granted to the Group (Note 11).

As of 31 December 2007, raw materials and finished goods with carrying amount of 149,949 thousand Russian Rubles (2006: nil) were pledged as security for short-term borrowings granted to the Group (Note 14).

OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (in thousand of Russian Rubles)

The Group long-term and short-term borrowings are repayable as follows:

	<u>31 December 2007</u>	<u>31 December 2006</u>
Due within three months	268,098	33,572
Due from three to twelve months	634,244	502,811
	<u>902,342</u>	<u>536,383</u>
Due in one to three years	<u>-</u>	<u>20,072</u>
Total	<u>902,342</u>	<u>556,455</u>

Certain reclassifications of prior year amounts have been made to conform with the current year presentation.

25. ACCRUALS AND OTHER PAYABLES

Short-term accruals as of 31 December 2007 and 2006 consisted of the following:

	<u>31 December 2007</u>	<u>31 December 2006</u>
Payroll and bonus accrual	66,995	39,679
Unused vacation accrual	7,041	4,634
Warranty provision	6,483	4,239
Other accruals and payables	7,603	3,555
Total	<u>88,122</u>	<u>52,107</u>

Certain reclassifications of prior year amounts have been made to conform with the current year presentation.

26. CASH FLOW FROM OPERATING ACTIVITIES

	<u>Year ended 31 December 2007</u>	<u>Year ended 31 December 2006</u>
Profit before taxation	791,785	415,843
Adjustments for:		
Depreciation of property, plant and equipment	43,538	36,876
Interest income	(46,499)	(13,185)
Interest expense	83,803	31,644
Share in profit of associates	(1,977)	(652)
Change in provision for doubtful receivables	3,133	(3,275)
Change in provision for slow-moving inventories	3,130	(5,394)
Loss on disposal of property, plant and equipment	2,043	18,597
Other adjustments	2,243	-

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (in thousand of Russian Rubles)

	Year ended 31 December 2007	Year ended 31 December 2006
Operating profit before working capital changes	881,199	480,454
Increase in inventories	(123,249)	(208,010)
Increase in trade accounts and other receivables	(422,923)	(261,401)
Increase in value-added tax and other taxes receivable (other than income tax)	(1,431)	(10,140)
(Decrease)/increase in trade accounts payables	(129,103)	85,122
Increase in short-term accruals and other payables	58,440	104
Increase/(decrease) in taxes payable (other than income tax)	619	(5,899)
Cash flows from operations	263,552	80,230

27. RELATED PARTIES

Included in the consolidated income statement for the year ended 31 December 2007 and 2006 are the following transactions with related parties:

	Year ended 31 December 2007	Year ended 31 December 2006
Revenue from related parties	2,857	13,553
Purchases from related parties	529,305	6,667
Interest income from related parties	8,431	5,068
Interest expense to related parties	236	-

Purchases from related parties during 2007 included 78,049 thousand Russian Rubles governance fee paid by the Group to LLC “OZNA-Management” for management of the Group.

Transactions with related parties are performed on terms that would not necessarily be available to unrelated parties.

The amounts outstanding are unsecured and will be settled in cash. No guarantees have been given or received. No provision has been made for doubtful debts in respect of the amounts owed by related parties.

Remuneration of key management personnel

Key management personnel of the Group receive short-term employee benefits. In 2007 and 2006 key management personnel received compensation of 29,003 and 11,586 thousand Russian Rubles respectively.

OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (in thousand of Russian Rubles)

28. FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of financial assets and liabilities is determined as follows:

- The fair value of financial assets and financial liabilities 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 financial assets and financial liabilities (excluding derivatives) are determined in accordance with generally accepted pricing model based on discounted cash flow analysis using prices from observable current market transactions.

Management believes that the carrying values of financial assets and financial liabilities recorded at amortised cost in the financial statements approximates their fair values.

29. RISK MANAGEMENT

Capital risk management

The Group manages its capital to ensure that entities of the Group will be able to continue as a going concern while maximising the return to the equity holder through the optimisation of the debt and equity balance. The management of the Group reviews the capital structure on a regular basis. Based on the results of this review, the Group takes steps to balance its overall capital structure through the payment of dividends, new share issues and share buy-backs as well as the issue of new debt or the redemption of existing debt.

Gearing ratio

The Group's capital structure as determined by gearing ratio at the year end was as follows:

	31 December 2007	31 December 2006
Debt (i)	902,342	556,455
Cash and cash equivalents (Note 18)	35,584	31,129
Net debt	866,758	525,326
Equity (ii)	1,331,193	924,843
Net debt to equity ratio	0.65	0.57

(i) Debt is defined as long-term and short-term borrowings, as detailed in Notes 20 and 24;

(ii) Equity includes share capital and all reserves of the Group.

OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (in thousand of Russian Rubles)

Major categories of financial instruments

The Group’s principle financial liabilities comprise loans and borrowings, trade payables and other payables and accruals. The main purpose of these financial instruments is to raise finance for the Group’s operations. The Group has various financial assets such as trade receivables, investments in securities and cash and cash equivalents.

	<u>31 December 2007</u>	<u>31 December 2006</u>
Financial assets		
Cash and cash equivalents	35,584	31,129
Bank deposits	-	103,002
Redeemable notes	3,963	61,773
Loans given	54,867	45,263
Trade receivables	539,877	188,011
Total financial assets	<u>634,291</u>	<u>429,178</u>
Financial liabilities		
Loans and borrowings	902,342	556,455
Trade payables	134,260	48,861
Total financial liabilities	<u>1,036,602</u>	<u>605,316</u>

The main risks arising from the Group’s financial instruments are interest rate, credit and liquidity risks.

Interest rate risk

Interest rate risk is the risk that changes in floating interest rates will adversely impact the financial results of the Group. The Group does not use any derivatives to manage interest rate risk exposure, at the same time the majority of the Group’s financial assets and liabilities are at fixed rates and thus risk is limited.

Credit risk

Credit risk is the risk that a customer may default or not meet its obligations to the Group on a timely basis, leading to financial losses to the Group.

The summary below shows the outstanding balances and turnover of top five counterparties as at the respective balance sheet dates and for the period then ended:

	Customer location	31 December 2007		31 December 2006	
		Turnover	Outstanding balance	Turnover	Outstanding balance
CJSC “Vankorneft”	Krasnoyarsk	675,187	178,135	185,226	-
LLC “UNG service”	Nefteugansk	332,765	91,441	36,878	6,613
OJSC “Gazprom neft”	St. Petersburg	136,416	74,413	60,737	-
OJSC “Surgutneftegaz”	Surgut	559,639	27,267	140,471	846
OJSC “NK Rosneft”	Moscow	278,278	22,100	756,168	83,433
Total		<u>1,982,285</u>	<u>393,356</u>	<u>1,179,480</u>	<u>90,892</u>

OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (in thousand of Russian Rubles)

Liquidity risk

Liquidity risk is the risk that the Group will not be able to settle all liabilities as they are due. The Group's liquidity position is carefully monitored and managed. The Group has in place a detailed budgeting and cash forecasting process to help ensure that it has adequate cash available to meet its payment obligations.

The summaries of maturity profile of the Group's consolidated financial liabilities as at 31 December 2007 and 2006 based on contractual payments are presented in Notes 22 and 24.

30. COMMITMENTS AND CONTINGENCIES

Litigation

The Group has been and continues to be the subject of legal proceedings and adjudications from time to time, none of which has had, individually or in the aggregate, a material adverse impact on the Group. Management believes that the resolution of all such matters will not have a material impact on the Group's consolidated financial position or operating results.

Taxation contingencies in the Russian Federation

The government of the Russian Federation has commenced a revision of the Russian tax system and passed certain laws implementing tax reform. The new laws reduce the number of taxes and overall tax burden on businesses and simplify tax legislation. However, these new tax laws continue to rely heavily on the interpretation of local tax officials and fail to address many existing problems. Many issues associated with practical implication of new legislation are unclear and complicate the Group's tax planning and related business decisions.

In terms of Russian tax legislation, authorities have a period of up to three years to re-open tax declarations for further inspection. Changes in the tax system that may be applied retrospectively by authorities could affect the Group's previously submitted and assessed tax declarations.

While management believes that it has adequately provided for tax liabilities based on its interpretation of current and previous legislation, the risk remains that the tax authorities in the Russian Federation could take differing positions with regard to interpretative issues. This uncertainty may expose the Group to additional taxation, fines and penalties that could be significant. Management estimates total unprovided amount of possible tax risks to be approximately 31,909 thousand Russian Rubles.

Environmental matters

The Group is subject to extensive federal and local environmental controls and regulations. The Group's management believes that the Group operations are in compliance with all current existing environmental legislation in the Russian Federation. However, environmental laws and regulations continue to evolve. The Group is unable to predict the timing or extent to which those laws and regulations may change, or the cost thereby.

OPEN JOINT STOCK COMPANY “AK OZNA” AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (in thousand of Russian Rubles)

Russian Federation risk

As an emerging market, the Russian Federation does not possess a fully developed business and regulatory infrastructure including stable banking and judicial systems, which would generally exist in a more mature market economy. The economy of the Russian Federation is characterised by a currency that is not freely convertible outside of the country, currency controls, low liquidity levels for debt and equity markets, and continuing inflation. As a result, operations in the Russian Federation involve risks that are not typically associated with those in more developed markets.

The stability and success of the Russian economy and the Group’s business mainly depends on the effectiveness of economic measures undertaken by the government as well as the development of legal and political systems.

Capital commitments

Contracted capital expenditures at 31 December 2007, amounted to 4,506 thousand Russian Rubles.

31. EVENTS AFTER THE BALANCE SHEET DATE

During first quarter of 2008, the Group received 79,920 thousand Russian Rubles for its share in LLC “Avtofirma OZNA”, which was shown as account receivable for the sale of the subsidiary as of 31 December 2007.

During January 2008, OJSC “AK OZNA” registered a bond issue on the Russian market for a total amount of 1,500,000 thousand Russian Rubles. Placement of bonds are planned for the second part of 2008.

During February 2008, the Group acquired 100% of the shares of LLC “Upravlenie Sredstv Avtomatizatsii” for a total cash consideration of 34,500 thousand Russian Rubles. The acquisition was made in accordance with the Group strategy of developing the service sector.

During February 2008, the Company OJSC “OZNA” was created by shareholders of the Group. All of the shares of OJSC “AK OZNA” were put to the share capital of OJSC “OZNA”. In March 2008, 100% control of OJSC “AK OZNA” was transferred to newly created company OJSC “OZNA”.

During May 2008, the Group opened a new credit line with the CJSC “UniCredit Bank” for a total amount of 500,000 thousand Russian Rubles at an annual interest rates 9.2%-11.2%.

In June 2008, the shareholders of the Group approved dividends of 117,086 thousand Russian Rubles (26 Russian Rubles per share) for the year 2007. These dividends will be paid till December 2008.

OPEN JOINT STOCK COMPANY "AK OZNA" AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007 (in thousand of Russian Rubles)

32. RESTATEMENT

Subsequent to the issuance of the Group's consolidated financial statements for the year ended 31 December 2006, the Group's management found and corrected errors in its fixed assets register. Management also re assessed a termination benefit, previously accounted for as defined benefit plan, and determined that the benefits should properly be accounted for as a termination benefits and that no liability should be recorded.

Accordingly, the Group restated its consolidated financial statements for the year ended 31 December 2006 to account for property, plant and equipment and terminations benefits.

The following is a summary of the effect of the restatements on the consolidated income statement:

	Year ended 31 December 2006		
	As previously reported	Adjustments	As restated
Cost of sales	(2,045,418)	13,366	(2,032,052)
Gross profit	759,202	13,366	772,568
Selling, general and administrative expenses	(344,491)	1,495	(342,996)
Profit before taxation	400,982	14,861	415,843
Profit for the year	289,658	14,861	304,519

The following is a summary of the effect of the restatements on the consolidated balance sheet:

	31 December 2006		
	As previously reported	Adjustments	As restated
Property, plant and equipment	510,744	13,366	524,110
Retained earnings	855,354	20,422	875,776
Retirement benefit obligation	7,056	(7,056)	-

	31 December 2005		
	As previously reported	Adjustments	As restated
Retained earnings	692,854	5,561	698,415
Retirement benefit obligation	5,561	(5,561)	-