Open Joint Stock Company "Russian Railroads"

Consolidated Financial Statements
prepared in accordance
with International Financial Reporting Standards

As of 31 December 2006 and for the year then ended

Open Joint Stock Company “Russian Railroads”

Consolidated Financial Statements

Year ended 31 December 2006

Contents

Independent Auditors’ Report 1

Consolidated Financial Statements

Consolidated Balance Sheet.....3
Consolidated Statement of Income 4
Consolidated Statement of Changes in Equity.....5
Consolidated Statement of Cash Flows 6
Notes to Consolidated Financial Statements.....7

Open Joint Stock Company "Russian Railroads"

Consolidated Balance Sheet

(All amounts are in millions of Russian Rubles)

	Notes	31 December 2006	2005 (restated)
ASSETS			
Non-current assets			
Property, plant and equipment	3	**1,421,073**	1,248,367
Intangible assets		**5,638**	4,624
Investments	4	**1,410**	1,198
Deferred tax asset	21	**13,297**	41,830
Other investments	5	**7,641**	1,294
Other non-current assets		**2,963**	2,972
Total non-current assets		**1,452,022**	1,300,285
Current assets			
Inventories	6	**54,632**	45,470
Prepayments and other current assets	7	**52,801**	68,388
Income tax receivable		**4,959**	463
Receivables	8	**21,070**	15,582
Cash and cash equivalents	9	**17,423**	12,200
Total current assets		**150,885**	142,103
Total assets		**1,602,907**	1,442,388
EQUITY AND LIABILITIES			
Equity			
Share capital	20	**1,535,700**	1,535,700
Revaluation reserve		**172,051**	172,051
Accumulated deficit		**(611,392)**	(701,241)
Net profit for the year attributable to equity holders of the parent		**139,766**	90,789
		1,236,125	1,097,299
Minority interest in subsidiaries	2	**213**	208
Total equity		**1,236,338**	1,097,507
Non-current liabilities			
Deferred tax liabilities	21	**121**	–
Long-term borrowings	12	**48,425**	50,739
Finance lease obligations, net of current portion	16	**40,821**	24,170
Employee benefit obligations	14	**70,269**	67,990
Other long-term debt	13	**2,853**	13,311
Total non-current liabilities		**162,489**	156,210
Current liabilities			
Payables	10	**95,289**	75,004
Finance lease obligations, current portion	16	**9,575**	5,557
Income tax payable		**76**	1,545
Taxes and similar charges payable	11	**24,443**	26,004
Short-term borrowings	12	**17,187**	18,092
Accrued and other liabilities	15	**57,510**	62,469
Total current liabilities		**204,080**	188,671
Total equity and liabilities		**1,602,907**	1,442,388

Andreev F.B. Senior Vice-President

Kraft G.V. Chief Accountant

31 August 2007

The accompanying notes are an integral part of these consolidated financial statements.

Open Joint Stock Company "Russian Railroads"

Consolidated Statement of Income

(All amounts are in millions of Russian Rubles)

	Notes	Years ended 31 December 2006	2005 (restated)
Revenues			
Cargo revenues		**673,894**	584,716
Passenger revenues		**118,426**	94,578
Other revenues		**85,568**	69,955
Total revenues		**877,888**	749,249
Operating expenses			
Wages, salaries and related contributions		**(286,445)**	(249,914)
Materials, repairs and maintenance		**(139,254)**	(137,730)
Fuel		**(50,329)**	(43,214)
Electricity		**(48,924)**	(44,968)
Depreciation and amortization	3	**(62,833)**	(67,228)
Taxes other than income tax, net	17	**(11,436)**	2,451
Commercial expenses		**(4,847)**	(5,368)
Bad debt expense		**(6,977)**	(2,965)
Social expenses	18	**(4,242)**	(8,581)
Other operating expenses		**(69,457)**	(57,356)
Total operating expenses		**(684,744)**	(614,873)
Operating profit before compensation from federal and municipal budgets		**193,144**	134,376
Compensation of transportation losses from federal and municipal budgets		**1,552**	1,628
Compensation of social expenses from federal and municipal budgets		**30**	18
Income from operations after compensation from federal and municipal budgets		**194,726**	136,022
Interest expense and similar items, net		**(6,933)**	(5,213)
Changes in fair value and recoverable amounts of investments		**940**	922
Other income, net	19	**12,968**	3,532
Foreign exchange gain/(loss), net		**1,537**	(186)
Income before taxation		**203,238**	135,077
Income taxes			
Current taxes		**(34,778)**	(21,613)
Deferred taxes		**(28,654)**	(22,624)
Total income taxes	21	**(63,432)**	(44,237)
Net income for the year		**139,806**	90,840
Attributable to:			
Equity holders of the parent		**139,766**	90,789
Minority interests in subsidiaries		**40**	51

Andreev F.B. Senior Vice-President

Kraft G.V. Chief Accountant

31 August 2007

The accompanying notes are an integral part of these consolidated financial statements.

Open Joint Stock Company "Russian Railroads"

Consolidated Statement of Changes in Equity

(All amounts are in millions of Russian Rubles, except share amounts)

		Equity attributable to equity holders of the parent						
		Share capital						
	Notes	Common shares	Amount	Revaluation surplus	Reserves / (accumulated deficit)	Total	Minority interests	Total equity
As at 1 January 2005 (as previously reported)		**,535,700,000**	**1,535,700**	–	**(757,148)**	**778,552**	**203**	**778,755**
Correction of errors	2	–	–	172,051	68,730	240,781	–	240,781
As at 1 January 2005 (as restated)		**,535,700,000**	**1,535,700**	**172,051**	**(688,418)**	**1,019,333**	**203**	**1,019,536**
Acquisition of minority interest in existing subsidiary		–	–	–	46	46	(46)	–
Dividends paid		–	–	–	(875)	(875)	–	(875)
Net income for the year (as restated)		–	–	–	90,789	90,789	51	90,840
		,535,700,000	**1,535,700**	**172,051**	**(598,458)**	**1,109,293**	**208**	**1,109,501**
Correction of errors	2	–	–	–	(11,994)	(11,994)	–	(11,994)
As at 31 December 2005 (as restated)		**,535,700,000**	**1,535,700**	**172,051**	**(610,452)**	**1,097,299**	**208**	**1,097,507**
Acquisition of minority interest in existing subsidiary		–	–	–	35	35	(35)	–
Dividends paid		–	–	–	(975)	(975)	–	(975)
Net income for the year		–	–	–	139,766	139,766	40	139,806
As at 31 December 2006		**,535,700,000**	**1,535,700**	**172,051**	**(471,626)**	**1,236,125**	**213**	**1,236,338**

Andreev F.B. Senior Vice-President

Kraft G.V. Chief Accountant

31 August 2007

Open Joint Stock Company "Russian Railroads"

Consolidated Statement of Cash Flows

(All amounts are in millions of Russian Rubles)

	Years ended 31 December	
	2006	**2005 (restated)**
Cash flows from operating activities		
Income before taxation and minority interests	**203,238**	135,077
Adjustments to reconcile income to cash generated from operations		
Depreciation and amortisation	**62,833**	67,228
Change in fair value and recoverable amounts of investments	**(940)**	(922)
Bad debt expense	**6,977**	2,965
(Gain)/Loss on disposal of property, plant, equipment	**(91)**	5,267
Impairment of abandoned construction-in-progress projects	**5,342**	5,639
Interest expense and similar items, net	**6,933**	5,213
(Reversal)/ accrual of provision for obsolescence and write-off of other assets	**(1,575)**	1,685
(Reversal) of provision for legal claims	**(2,594)**	(2,170)
(Reversal) of provision for expenses related to social assets transferred to local municipalities	**(1,584)**	–
(Reversal) of provision for tax risks	**(4,220)**	(16,335)
Foreign exchange (gain)	**(1,537)**	–
(Gain) on receipt of scrap materials in the result of PP&E repair or disposal, net	**(6,875)**	–
(Gain) on release of penalties related to tax restructuring (other than income tax)	**(8,276)**	(4,491)
Operating income before working capital changes	**257,631**	199,156
(Increase) in receivables	**(11,963)**	(4,191)
Decrease/ (increase) in prepayments and other current assets	**15,194**	(11,836)
(Increase) in inventories	**(2,939)**	(6,215)
Increase/ (decrease) in payables	**20,285**	(2,711)
(Decrease) / increase in taxes and similar charges payable including restructured taxes	**(2,049)**	7,137
Increase in other liabilities	**3,438**	3,936
Increase in employee benefit obligations	**2,279**	6,351
Decrease / (Increase) in other non-current assets	**100**	(1,664)
Net cash from operating activities before income taxes	**281,976**	189,963
Income taxes paid	**(42,435)**	(24,717)
Net cash from operating activities	**239,541**	165,246
Cash flows from investing activities		
Capital expenditures	**(209,044)**	(190,950)
Proceeds from disposal of property, plant and equipment	**897**	572
Purchase of intangibles, net	**(2,336)**	(3,031)
Proceeds from disposal of marketable securities, loans given, deposits placed, net	**(5,455)**	1,400
(Purchase) of investments	**(24)**	(236)
Interest received	**992**	–
Net cash (used in) investing activities	**(214,970)**	(192,245)
Cash flows from financing activities		
Repayment of finance lease obligations	**(6,573)**	(4,569)
Proceeds from long-term borrowings	**14,595**	42,675
Repayment of short-term borrowings, net	**(14,873)**	(2,809)
Repayment of long-term borrowings	**(1,463)**	–
Interest paid	**(11,115)**	(6,743)
Dividends paid	**(975)**	(875)
Government grants	**1,056**	875
Net cash (used in)/ from financing activities	**(19,348)**	28,554
Net increase in cash and cash equivalents	**5,223**	1,555
Cash and cash equivalents at the beginning of the year	**12,200**	10,645
Cash and cash equivalents at the end of the year	**17,423**	12,200

Andreev F.B. Senior Vice-President

Kraft G.V. Chief Accountant

31 August 2007

The accompanying notes are an integral part of these consolidated financial statements.

1. Description of Business and Russian Environment

Formation and Operations of the Company

The Ministry of Railways of the Russian Federation (hereinafter "MPS") was established in January 1992 as a successor of the Ministry of Railway Transportation of the USSR under decree No. 28 of the President of the Russian Federation.

Through 30 September 2003 MPS had combined the function of a federal agency executing regulation of railway transportation in the territory of Russia and the function of a commercial entity. Pursuing the objective of (1) segregation of the regulatory functions of MPS and its commercial activities; and (2) development of competition in the transportation market, the Russian government commenced implementation of the Program of railway transportation restructuring during the period 2001-2010 ("the Program") developed by MPS, the Ministry of Economic Development and Trade of the Russian Federation, the Antimonopoly Ministry of Russian Federation, Ministry of State Property of the Russian Federation and certain other ministries. This Program's ultimate purpose is the attraction of capital investments necessary to upgrade and replace existing property, plant and equipment.

As the first significant step of the Program, a new company – open joint stock company "Russian Railroads" ("RZD" or "the Company") was established on 1 October 2003 as a successor to MPS in its capacity as a commercial entity pursuant to Decree of the Russian Government No. 585 "On Foundation of Joint Stock Company RZD" dated 18 September 2003. The Company is 100% owned by the Russian government. MPS as a governmental body retained tariffs regulating and other policy-setting functions. In July, 2004 these functions were transferred to the Ministry of Transport of the Russian Federation.

As a result of the reorganization of MPS, RZD retained all operating assets, infrastructure and employees of MPS as well as its commercial operations, and the Russian government became a direct holder of the stock of RZD. The reorganization of MPS and transfer of assets and liabilities to RZD was treated by management as reorganization of entities under common control, and was reported as though the reorganization and transfer of net assets occurred as of 1 January 2003. The Company has reflected all assets and liabilities transferred from MPS to RZD at the predecessor's accounting basis in the accompanying financial statements.

Further, as part of the reorganization a part of MPS's social assets (primarily living houses) were transferred to the local municipalities. RZD assumed a liability related to repair and renovation of such social assets upon transfer. This liability as of 31 December 2006, in the amount of Rbls 606 (2005: Rbls 2,515) was included in "Accrued and other liabilities" in the accompanying consolidated balance sheet with the corresponding expenses included in "Social expenses" in the consolidated statement of income (refer to Notes 15 and 18). Further, the Company committed to continue financing costs related to maintenance of the assets referred to above during 2007 (refer to Note 23 for further details).

In addition, the Government contributed land occupied by the Company's facilities as in-kind contribution to the newly established share capital of RZD (refer to Note 3).

1. Description of Business and Russian Environment (continued)

Formation and Operations of the Company (continued)

RZD is comprised of the following departments:

a) Railways:

Oktiabrskaya;
Moskovskaya;
Severo-Kavkazskaya;
Privolzhskaya;
Uzhnouralskaya;
Vostochno-Sibirskaya;
Kaliningradskaya;
Gorkovskaya;
Ugo-Vostochnaya;
Kuibyshevskaya;
Zapadno-Sibirskaya;
Zabaikalskaya;
Severnaya;
Sverdlovskaya;
Krasnoyarskaya;
Sakhalinskaya;
Dalnevostochnaya.

b) Operating organizations:

Railway traffic control centre;
Firm service centre of transportation;
Main information processing centre;
Central telecommunication centre;
Roszheldorsnab;
Railway transport construction Directorate;
Federal passenger Directorate;
Central cars' repair Directorate.

c) Industrial organizations:

Electro technical plants;
Passenger car repair plants;
Locomotives and wagons repair plants;
Concrete sleeper manufacturing plants;
Specialized plants.

d) Medical and healthcare institutions

RZD activities will be focused solely on provision of transportation services and maintenance of railroads infrastructure. Under the terms of the Program it is planned that auxiliary business activities and the related facilities currently owned by RZD will be further transferred to independent newly established entities.

Corporate Information

The legal address of RZD is Novaya Basmannaya Street 2, 107174 Moscow, the Russian Federation.

The accompanying consolidated financial statements were authorised for issue by RZD's directors on 31 August 2007.

1. Description of Business and Russian Environment (continued)

Consolidated Subsidiaries

Details of RZD's entities included in the consolidation as of 31 December 2006 and for the year then ended are as follows:

Name of Company	Registered offices	Legal form	Nature of business	Parent Company	Equity interest
TransTelecom	Moscow	Closed Joint Stock Company	Fiber-optic cable construction	RZD	100%
Arena 2000	Yaroslavl	Closed Joint Stock Company	Hockey stadium operations	RZD	99.9%
Elteza	Moscow	Open Joint Stock Company	Production of electrical engineering equipment	RZD	100% - 1 common share
Remputmash	(A)	(A)	Repair works	RZD	100% - 1 common share
TransContainer (B)	Moscow	Open Joint Stock Company	Forwarding Agent, Container transportation	RZD	100% - 1 common share
Roszheldorstroy (B)	Moscow	Open Joint Stock Company	Construction works	RZD	100%
Roszheldorproekt (B)	Moscow	Open Joint Stock Company	Construction works	RZD	100%
Refservice (B)	Moscow	Open Joint Stock Company	Refrigerator transportation	RZD	100%
Locomotiv Football club (C)	Moscow	Close Join Stock Company	Football club	RZD	70%
Zhilsotsipoteka	Moscow	Limited Liability Company	Residential construction	RZD	100%
Zheldoripoteka	Moscow	Closed Joint Stock Company	Residential construction	RZD	100%

(A) These entities were established by RZD during 2005 on the basis of branches previously existing and comprise auxiliary business activities and the related facilities. "Remputmash" comprises 9 separate legal entities. All entities are established as open joint stock companies.
(B) These entities were established by RZD in 2006 on the basis of the branches previously existing.
(C) In 2006 management concluded that because of the growth of activities of the football club during 2006 consolidation of this entity is justified.

1. Description of Business and Russian Environment (continued)

Consolidated Subsidiaries (continued)

Details of RZD's entities included in the consolidation as of 31 December 2005 and for the year then ended are as follows:

Name of Company	Registered offices	Legal form	Nature of business	Parent Company	Equity interest
TransTelecom	Moscow	Closed Joint Stock Company	Fiber-optic cable construction	RZD	100%
Arena 2000	Yaroslavl	Closed Joint Stock Company	Hockey stadium operations	RZD	99.9%
Elteza	Moscow	Open Joint Stock Company	Production of electrical engineering equipment	RZD	100% - 1 common share
Remputmash	(A)	(A)	Repair works	RZD	100% - 1 common share
Zhilsotsipoteka	Moscow	Limited Liability Company	Residential construction	RZD	100%
Zheldoripoteka	Moscow	Closed Joint Stock Company	Residential construction	RZD	100%

(A) These entities were established by RZD during 2005 on the basis of branches previously existing and comprise auxiliary business activities and the related facilities. "Remputmash" comprises 9 separate legal entities. All entities are established as open joint stock companies.

In addition, during 2005 RZD established a number of medical organizations and sanatoriums, which are also included in the consolidation as of 31 December 2006 and 2005 and for the years then ended.

Further, during 2006 and 2005 RZD established a number of 51% owned rural passenger transportation companies, which are included in the consolidated financial statements as of 31 December 2006 and 2005 and for the years then ended.

Further, the Company has equity investments in approximately 134 (2005: 115) various subsidiaries and associated undertakings not listed above. The aggregate amount of such investments (before provision for diminution of value) equated to Rbls 3,754 as of 31 December 2006 (2005: Rbls 4,600). For details of such investments - refer to Note 4.

Management believes that the financial position and results of operations of these entities are not likely to be material, individually or in aggregate, to the Company's consolidated financial statements. In particular, based on management assessment, the aggregate amount of assets, liabilities, revenues and net income of such unconsolidated entities do not exceed 1% of the consolidated assets, liabilities, revenues and profits of the Company as of 31 December 2006 and 2005 and for the years then ended.

On this basis, the above entities have been excluded from the scope of consolidation and / or application of equity method of accounting. Investments in such entities are reflected at historical cost of acquisition net of provision for diminution in value (refer to Notes 2 and 4).

1. Description of Business and Russian Environment (continued)

Factors Affecting Financial Position of the Company

Economic environment in Russia

Whilst there have been improvements in the Russian economic situation, such as an increase in gross domestic product and a reduced rate of inflation, Russia continues economic reforms and development of its legal, tax and regulatory frameworks as required by a market economy. The future stability of the Russian economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government.

Pricing policy

Tariffs for domestic cargo transportation

Domestic cargo transportation is a natural monopoly subject to regulation in accordance with Federal Law No.147-FZ on Natural Monopolies of 17 August 1995.

The list of tariffs for domestic cargo transportation services is included in the Statutory Price List 10-01 approved by the Federal Energy Commission of the Russian Federation effective since June 2003 that superseded the Statutory Price List 10-01 approved by the State Committee on Prices of the USSR and the Ministry of Railways of the USSR in March 1989.

Domestic cargo tariffs are denominated in Russian Rubles and are subject to inflation adjustments in line with a change of consumer prices. Indexation of tariffs is performed by the Federal Agency for Tariffs and the government of the Russian Federation based on the forecast of economic development of the Russian Federation provided by the Ministry of Economic Development and Trade.

Tariffs for domestic transportation of passengers and baggage

Domestic transportation of passengers and baggage is a natural monopoly subject to regulation in accordance with Federal Law No.147-FZ on Natural Monopolies of 17 August 1995.

The list of tariffs for transportation of passengers and baggage is included in the Statutory Price List 10-02-16 approved by the State Committee on Prices of the Russian Federation effective since March 1993.

Federal and local authorities subsidize part of the rural passenger transportation losses under cooperation agreements with the Company.

1. Description of Business and Russian Environment (continued)

Factors Affecting Financial Position of the Company (continued)

Tariffs for international transportation of cargo and passengers

(1) CIS rail tariffs

CIS rail tariffs apply to:

- cargo transit via CIS railways;
- third country cargo transportation to/from the CIS;
- cargo transportation between CIS rail terminals.

Tariffs for cargo transit are based on the International Rail Transit Tariff and Unified Transit Tariff denominated in Swiss francs with the exception of container transit services where tariffs are denominated in US dollars. The tariffs are approved by CIS Rail Transport Tariff Conference every year and the adopted tariffs are applied to settlements with forwarding companies. Tariffs for third country cargo transportation to/from the CIS and cargo transportation between CIS rail terminals are based on the Statutory Price List 10-01 approved by the Federal Energy Commission of the Russian Federation in June 2003.

The interstate passenger tariffs applicable to settlements for interstate passenger transportation services are approved by the CIS Rail Transport Tariff Conference.

(2) Tariffs for Western Europe, Baltic countries and Russia

International Transit Tariff used in cases when a cargo owner pays for the transportation services directly, as well as the "East-West" tariffs for transportation through Russia to European countries, which are not members of the CIS, are determined by the CIS Rail Transport Tariff Conference.

(3) Tariffs for Asian countries

Unified Transit Tariff and International Passenger Tariff applied in international railway transportation are determined by an intergovernmental agreement of the Amalgamated Union of Railways, which includes the members of the CIS and Baltic countries, North Korea, China and other countries of South-East Asia.

Currency Exchange and Control

Foreign currencies, in particular the US dollar, play a significant role in the underlying economics of many business transactions in Russia. The following table summarizes the exchange rate of the Ruble to 1 US dollar for the years ended 31 December 2006, 2005 and 2004:

As of 31 December	Exchange rate
2006	26.33
2005	28.78
2004	27.75

As of 31 August 2007 the exchange rate was Rubles 25.65 to 1 US dollar.

1. Description of Business and Russian Environment (continued)

Government Subsidies

Under the current cooperation agreements between the Company and federal and local governments, part of the losses from certain activities are covered by subsidies from such authorities. Further, a part of the Company's social costs is also subsidized. These compensations are shown as a separate item in the consolidated statement of income.

Liquidity

As of 31 December 2006, the Company's current liabilities exceeded its current assets by Rbls 53,195 (as of 31 December 2005: Rbls 46,568). As a result, uncertainties exist as to the Company's liquidity.

The Company is investing in expansion, modernization and maintenance of its property, plant and equipment. The Company financed investment activities through cash generated from operations and current and non-current liabilities. The Company also requires access to debt financing.

Management is addressing the Company's liquidity needs by implementing the following measures:

- Continuous negotiations with the government of the Russian Federation regarding the increase in transportation tariffs,
- Maintaining the system of collection of prepayments for transportation services,
- If needed, certain investment projects may be deferred or curtailed in order to fund the Company's current operating needs,
- Attracting borrowings from lending institutions.

Through 2007, management believes that there will be sufficient funding from (a) existing cash balances, (b) cash generated from operations, and (c) other financing from lending institutions.

2. Summary of Significant Accounting Policies

Basis of Presentation

The Company and its subsidiaries maintain their accounting records and prepare their statutory accounting reports in Russian Rubles and in accordance with the Regulations on Accounting and Reporting in the Russian Federation. The accompanying consolidated financial statements are based upon the statutory accounting records, which are maintained under the historical cost convention, except for the statutory revaluation of property, plant and equipment. The statutory accounting reports have been restated through adjustments and reclassifications to present these consolidated financial statements in accordance with International Financial Reporting Standards ("IFRS"). The principle adjustments relate to revenues recognition, valuation of property, plant and equipment, provisions, deferred income taxes and accounting for subsidiaries and associates.

2. Summary of Significant Accounting Policies (continued)

Principles of Consolidation

1. In accordance with IAS 27 "Consolidated Financial Statements and Accounting for Investments in Subsidiaries" ("IAS 27"), subsidiary undertakings are defined as those entities over which a reporting entity exercises control directly or indirectly and normally holds a voting interest of 50% or more.
2. The purchase method of accounting is used for acquired businesses. Companies acquired and disposed of during the year are included in the consolidated financial statements from the date of acquisition to the date of disposal. The equity and income attributable to minority shareholders' interests are shown under "Minority interest in subsidiaries" in the consolidated balance sheet and consolidated statement of income, respectively. Minority interests as of 31 December 2006 and 2005 and for the years then ended represent the interests in TransTelecom and rural passenger transportation companies, not held by the Company.
3. All significant balances and transactions between the Company and material subsidiary undertakings included in the consolidation are eliminated, as are costs and revenues recognised on intercompany transactions (e.g. entities providing services within the Company) and the unrealised profits within the Company.
4. When there is other than temporary diminution in value of the investment the carrying amount of the investment is reduced to the recoverable amount to recognise this decline.

In accordance with IAS 28 "Accounting for Investments in Associates" ("IAS 28"), associates are defined as those entities over which a reporting entity exerts significant influence and normally holds a voting interest of between 20% and 50% and are accounted for using the equity method.

As commented in Note 1, management assessed that the financial position and the results of operations of these entities were not material, individually or in aggregate, for the Company's consolidated financial statements. Investments in companies not included in the consolidation are stated at cost in the consolidated balance sheet (refer to Notes 4 and 5).

Changes in Accounting Policies

The accounting policies adopted are consistent with those of the previous financial year except that the Company has adopted those new/revised standards mandatory for financial years beginning on or after 1 January 2006.

The changes in accounting policies result from adoption of the following new or revised standards and interpretations:

- IFRS 6 "Exploration for and Evaluation of Mineral Resources";
- IAS 19 (amended 2005) "Employee benefits";
- IAS 21 (amended 2005) "The Effects of Changes in Foreign Exchange Rates";
- IAS 39 (amended 2005) "Financial Instruments: Recognition and Measurement"
- IFRIC 4 "Determining whether an Arrangement contains a Lease";
- IFRIC 5 "Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds".

2. Summary of Significant Accounting Policies (continued)

Changes in Accounting Policies (continued)

The principal effects of these changes in policies are discussed below.

IAS 19 (amended 2005) "Employee benefits"

As of 1 January 2006, the Group adopted the amendments to IAS 19. As a result, additional disclosures are made providing information about trends in the assets and liabilities in the defined benefit plans and the assumptions underlying the components of the defined benefit cost. This change has resulted in additional disclosures being included for the years ending 31 December 2006 and 2005 but has not had a recognition or measurement impact, as the Group chose not to apply the new option offered to recognize actuarial gains and losses outside of the income statement.

IAS 39 (amended 2005) "Financial Instruments: Recognition and Measurement"

The amendment to IAS 39 in 2005

- required to include financial guarantee contacts issued;
- permitted the foreign currency risk of a highly probable intra-group forecast transaction to qualify as the hedged item in cash flow hedge, provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and that the foreign currency risk will affect the financial statements;
- restricted the use of the option to designate any financial asset or any financial liability to be measured at fair value through profit and loss.

These amendments did not have an effect on RZD's financial statements.

IFRIC 4 "Determining whether an Arrangement contains a Lease"

IFRIC 4 provides guidance for determining whether arrangements are, or contain, leases that should be accounted for in accordance with IAS 17, if the arrangements comprise a transaction or a series of related transactions, that does not take the legal form of a lease but conveys a right to use an asset in return for a payment or series of payments. The adoption of this IFRIC Interpretation as of 1 January 2006 has not had an impact on RZD's financial statements as at 31 December 2006 or 31 December 2005.

IFRIC 5 "Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds"

IFRIC 5 explains how to treat expected reimbursements from funds set up to meet the costs of decommissioning assets or in undertaking environmental restoration or rehabilitation. This interpretation has had no impact on the financial statements of RZD.

2. Summary of Significant Accounting Policies (continued)

Changes in Accounting Policies (continued)

IFRSs and IFRIC Interpretations not yet effective

The Company has not applied the following IFRSs and IFRIC Interpretations that have been issued but are not yet effective:

- IFRS 7 "Financial Instruments: Disclosures";
- IFRS 8 "Operating Segments";
- IAS 1 (amended 2005) "Presentation of Financial Statements – Capital Disclosures";
- IAS 23 (Revised) "Borrowing Costs";
- IFRIC 8 "Scope of IFRS 2";
- IFRIC 9 "Reassessment of Embedded Derivatives";
- IFRIC 10 "Interim Financial Reporting and Impairment";
- IFRIC 11 "IFRS 2 - Group and Treasury Share Transactions";
- IFRIC 12 "Service Concession Arrangements";
- IFRIC Interpretation 14 IAS 19 "The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction".

IFRS 7 "Financial Instruments: Disclosures" replaces the disclosure requirements of IAS 32 and must be applied for annual reporting periods that commence on or after 1 January 2007.

IFRS 8 "Operating Segments" is effective for annual periods beginning on or after 1 January 2009 and requires an entity to report financial and descriptive information about its operating segments and specifies how an entity should report such information. The standard eliminated the principle of identification of two sets of segments, and requires identifying the operating segments. Further, the standard revised the principle of measurement of the amounts reported for each operating segment item by requiring that such amounts to be the measure reported to the chief operating decision maker for the purposes of allocating resources to the segment and assessing its performance. In addition, the standard requires a disclosure of factors used to identify the entity's operating segments.

The amendment of IAS 1 "Presentation of Financial Statements – Capital Disclosures" requires disclosures regarding an entity's objectives, policies and processes for managing capital. The provisions are effective for reporting periods beginning on or after 1 January 2007.

IAS 23 (Revised) removed the option of immediate recognition as an expense of borrowing costs that relate to assets that take a substantial period of time to get ready for use or sale. The revised standard applies to borrowing costs relating to qualifying assets for which the commencement date for capitalization is on or after 1 January 2009.

IFRIC 8 clarifies that IFRS 2 applies to arrangements where an entity makes share-based payments for apparently nil or inadequate consideration. If the identifiable consideration given appears to be less than the fair value of the equity instrument granted, under IFRIC 8 this situation typically indicates that other consideration has been or will be received. IFRS 2 therefore applies. IFRIC 8 becomes effective for financial years beginning on or after 1 May 2006.

2. Summary of Significant Accounting Policies (continued)

Changes in Accounting Policies (continued)

IFRSs and IFRIC Interpretations not yet effective (continued)

IFRIC 9 clarifies, that an entity shall assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative when the entity first becomes a party to the contract. Subsequent reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract, in which case reassessment is required. An entity shall apply this interpretation for annual periods beginning on or after 1 June 2006.

Applying IFRIC 10, an entity shall not reverse an impairment loss recognized in a previous interim period in respect of goodwill or an investment in either an equity instrument or a financial asset carried at cost. An entity shall apply this interpretation for annual periods beginning on or after 1 November 2006.

IFRIC 11 addresses the issues whether certain transactions should be accounted for as equity-settled or as cash-settled under the requirements of IFRS 2, and concerns the accounting treatment for share-based payment arrangements that involve two or more entities within the same group. An entity shall apply this interpretation for annual periods beginning on or after 1 March 2007.

IFRIC 12 is relevant for private sector entities that provide public sector services such as roads, airports, energy and water supply under a concession arrangement. Under such arrangements, control of the assets under concession is not necessarily in private hands, but the private sector operator is responsible for construction activities, as well as for operating and maintaining the public sector infrastructure. In the private sector operator's balance sheet, the assets are not recognized as property, plant and equipment, but as financial and/or intangible assets depending on the nature of the arrangement. An entity shall apply this Interpretation for annual periods beginning on or after 1 January 2008.

IFRIC 14 addresses the measurement of defined benefit plan assets and accounting for an obligation under a minimum funding requirement. An entity shall apply this Interpretation for annual periods beginning on or after 1 January 2008.

The Company expects that the adoption of the pronouncements listed above will not have a significant impact on the Company's financial statements in the period of initial application. Adoption of IFRS 7 will significantly affect the disclosures relating to financial instruments as presented in the notes to the financial statements. Further, adoption of IFRS 8 will affect the segment reporting disclosures in the note to the financial statements.

2. Summary of Significant Accounting Policies (continued)

Prior Period Errors

The Company corrects material prior period errors retrospectively in the first set of financial statements authorized for issue after their discovery by restating the comparative amounts for the prior period presented in which the error occurred or if the error occurred before the earliest prior period presented, by restating the opening balances of assets, liabilities and equity for the earliest prior period presented.

Prior period error is corrected by retrospective restatement except to the extent that it is impracticable to determine either the period-specific effects or the cumulative effect of the error.

Correction of prior year financial statements

Valuation of Property, Plant and Equipment

During 2006 the Company completed revaluation of one category of its property, plant and equipment – sub-grade (refer below) as of 1 January 2004. Such revaluation was performed by an independent appraiser engaged by the Company. As a result, the carrying value of property included in this category increased by Rbls 226,383. This increase was reported as revaluation surplus as of 1 January 2004, net of provision of deferred income tax of Rbls 54,332. Accordingly, the Company restated its financial statements for 2005 to consider the effects of revaluation referred to above, including the effects on depreciation, the value of derecognised parts of sub-grade items subjected to repairs during 2004 and 2005, and the value of items considered impaired as of 31 December 2005 and 2004.

In addition, the Company re-assessed the amount of deferred tax asset reported in the financial statements and recorded previously unrecognized amounts of deferred tax asset (refer to Note 21).

Accordingly, the Company restated its financial statements for 2005.

As a result of a correction of the above error, net income for the year ended 31 December 2005 decreased by Rbls 23,570 (net of income tax charge of Rbls 20,537). Further, the balance of revaluation reserve as of 1 January 2005 increased by Rbls 172,051 (net of income tax of 54,332), and the amount of accumulated deficit as of 1 January 2005 decreased by Rbls 68,730 (net of income tax of Rbls 17,415).

Employee benefits

The Company discovered an error in the application of the projected unit credit method in periods prior to 2006. Management resolved that it is impracticable to determine the period-specific effects of this error on comparative information presented. Accordingly, the cumulative effect of this error was recognized by restating the balance of defined benefit liabilities as of 31 December 2005. As a result, employee benefits obligations as of 31 December 2005 increased by Rbls 14,246. This increase was reported as an increase in accumulated deficit as of 31 December 2005, net of provision for deferred income tax of Rbls 2,252. There was no impact on previously reported pension expenses for the year ended 31 December 2005.

2. Summary of Significant Accounting Policies (continued)

Comparative Information

Certain reclassifications were made to comparative financial information for the year ended 31 December 2005 to comply with the current year presentation. Such reclassifications related primarily to the results of disposal of property, plant and equipment in the statement of income, and allocation of certain expenses between segments in footnote disclosures.

Measurement Currency

Based on the economic substance of the underlying events and circumstances relevant to the Company the functional currency of the Company has been determined to be the Russian Ruble.

Accounting for the Effects of Inflation

Before 2003 the Russian economy was considered hyperinflationary as defined by International Accounting Standard ("IAS") 29 "Financial Reporting in Hyperinflationary Economies". The effect of applying IAS 29 is that non-monetary items, including components of equity, were restated to the measuring units current as of 31 December 2002, based on the Russian general consumer price indices (CPI), issued by the State Statistical Committee of the Russian Federation, and these restated values were used as a basis for accounting in subsequent periods.

Use of Management Estimates

The preparation of consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the reported amounts of revenues and costs during the reporting period.

As a result of the uncertainties inherent in business activities, many items in financial statements cannot be measured with precision but can only be estimated. Estimation involves judgments based on the latest available, reliable information. An estimate may need revision if changes occur in the circumstances on which the estimate was based or as a result of new information or more experience.

The most significant estimates relate to the realisability and depreciable lives of property, plant and equipment, the realisability of long-term financial investments, allowance for doubtful accounts, provision for obsolete inventory, provision for tax contingencies and deferred taxation. Actual results could differ from these estimates.

Estimation Uncertainty

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 are discussed below:

2. Summary of Significant Accounting Policies (continued)

Estimation Uncertainty (continued)

Useful life of property, plant and equipment

The Company assesses the remaining useful lives of items of property, plant and equipment at least at each financial year-end. If expectations differ from previous estimates, the changes are accounted for as a change in an accounting estimate in accordance with IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors". These estimates may have a material impact on the amount of the carrying values of property, plant and equipment and on depreciation recognized in profit or loss.

Impairment of property, plant and equipment

The Company assesses at each reporting date whether there is any indication that an asset may be impaired. If any such indication exists, the Company makes an estimate of the asset's recoverable amount. An asset's recoverable amount is higher of an asset's or cash-generating unit's fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or group of assets. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. 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 assessment of the time value of money and the risks specific to the assets. In 2006, the Company recognized an impairment loss of 5,342 (2005: 5,639). More details are provided in Note 3.

The determination of impairment of property, plant and equipment involves the use of estimates that include, but are not limited to, the cause, timing and amount of the impairment. Impairment is based on a large number of factors, such as changes in current competitive conditions, expectations of growth in the industry, increased cost of capital, changes in the future availability of financing, technological obsolescence, discontinuance of service, current replacement costs and other changes in circumstances that indicate impairment exists. The determination of the recoverable amount of a cash-generating unit involves the use of estimates by management. Methods used to determine the value in use include discounted cash flow-based methods, which require the Company to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows. These estimates, including the methodologies used, may have a material impact on the fair value and ultimately the amount of any property, plant and equipment impairment.

Allowance for doubtful accounts

Management maintains an allowance for doubtful accounts to account for estimated losses resulting from the inability of customers to make required payments. When evaluating the adequacy of an allowance for doubtful accounts, management bases its estimates on the aging of accounts receivable balances and historical write-off experience, customer credit worthiness and changes in customer payment terms. If the financial condition of customers were to deteriorate, actual write-offs might be higher than expected. As of 31 December 2006, allowances for doubtful accounts have been created in the amount of 15,450 (2005: 9,616).

2. Summary of Significant Accounting Policies (continued)

Estimation Uncertainty (continued)

Pension obligations – defined benefit pension plans

The present value of defined post-employment benefit obligations and related current service cost are determined in accordance with actuarial valuation, which rely on demographic and financial assumptions including mortality, both during and after employment, rates of employee turnover, discount rate, future salary and benefit levels and, to a limited extent, expected return on plan assets. In the event that further changes in the key assumptions are required, the future amounts of the pension benefit costs may be affected materially. More details are provided in Note 14.

Litigations

The Company exercises considerable judgment in measuring and recognizing provisions and the exposure to contingent liabilities related to pending litigations or other outstanding claims subject to negotiated settlement, mediation, arbitration or government regulation, as well as other contingent liabilities. Judgement is necessary in assessing the likelihood that a pending claim will succeed, or a liability will arise, and to quantify the possible range of the final settlement. Because of the inherent uncertainties in this evaluation process, actual losses may be different from the originally estimated provision. These estimates are subject to change as new information becomes available, primarily with the support of internal specialists, if available, or with the support of outside consultants, such as actuaries or legal counsel. Revisions to the estimates may significantly affect future operating results.

Current taxes

Russian tax, currency and customs legislation is subject to varying interpretations and changes occur frequently. Further, the interpretation of tax legislation by tax authorities as applied to the transactions and activity of the Company's entities may not coincide with that of management. As a result, tax authorities may challenge transactions and the Company's entities may be assessed additional taxes, penalties and interest, which can be significant. Periods remain open to review by the tax and customs authorities with respect to tax liabilities for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods. As of 31 December 2006 management believes that its interpretation of the relevant legislation is appropriate and that it is probable that the Company's tax, currency and customs positions will be sustained. More details are provided in Note 23.

Deferred tax assets

Management judgment is required for the calculation of current and deferred income taxes. Deferred tax assets are recognized to the extent that their utilization is probable. The utilization of deferred tax assets will depend on whether it is possible to generate sufficient taxable income in respective tax jurisdiction. Various factors are used to assess the probability of the future utilization 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. In the event that an assessment of future utilization indicates that the carrying amount of deferred tax assets must be reduced, this reduction is recognized in profit or loss.

2. Summary of Significant Accounting Policies (continued)

Judgements

In the process of applying the Company's accounting policies, management has made the following judgements, apart from those involving estimates, which have the most significant effect on the amounts recognised in the consolidated financial statements:

Accounting for non-production property, plant and equipment

Included in property, plant and equipment are social infrastructure and other non-production assets. Management believes that expenditures incurred in respect of acquisition or construction of such assets qualify for the recognition as an asset on the premises that such expenditures are capable of contributing indirectly to the flow of cash and cash equivalents to the Company through a reduction of cash outflows related primarily to wages and salaries expenses. This is driven by the fact that such non-production assets are employed by the Company to provide in-kind benefits to its employees, which replace cash outflows on wages and salaries.

Accounting for leases

A lease is classified as finance lease if it transfers substantially all the risks and rewards incidental to ownership, otherwise it is classified as operating lease. Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract. In determining the accounting treatment of transactions that involve the legal form or a lease, all aspects and implications of an arrangements are evaluated to determine the substance of such transactions with weight given to those aspects and implications that have an economic effect. If the lease term is for longer than 75 percent of the economic life of the asset, or that at the inception of the lease the present value of the minimum lease payments amount to at least 90 percent of the fair value of the leased asset, the lease is classified by the Company as finance lease, unless it is clearly demonstrated otherwise.

Property, Plant and Equipment

Initial recognition of property, plant and equipment

In accordance with IAS 16 "Accounting for Property, Plant and Equipment" property, plant and equipment, which qualifies for recognition as an asset is initially recognised at its cost.

Subsequent to initial recognition, property, plant and equipment are carried at a revalued amount, being their fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment loss. Revaluations are made with sufficient regularity such that the carrying amount of property, plant and equipment does not differ materially from that, which would be determined using the fair value at the balance sheet date.

2. Summary of Significant Accounting Policies (continued)

Property, Plant and Equipment (continued)

Revaluation to fair value as of 31 December 1998

As of 31 December 1998, the Company performed a revaluation of its property, plant and equipment and reported these assets at their fair values.

For the purposes of determination of the fair values of property, plant and equipment, the Company engaged a consortium of independent appraisal companies to perform an appraisal of such fair values of a major part of property, plant and equipment as of 1 January 2000. The results of the appraisal performed were rolled backed to eliminate the effect of the changes in the market values of 1999, which were limited to inflation effects only, to arrive at fair value data as of 31 December 1998. Further, accumulated depreciation was eliminated against the gross carrying amount of related assets. The increase of Rbls 590,799 in the carrying amount of property, plant and equipment resulting from such revaluation was credited directly to equity as a revaluation surplus as of 31 December 1998.

Revaluation to fair value as of 1 January 2004

In 2004 the Company engaged an independent appraiser to determine the fair value of its property, plant and equipment as of 1 January 2004. The Company planned to complete this revaluation and report its property, plant and equipment at their fair values in its consolidated financial statements in 2005 by adjusting as needed the financial data for comparative financial statements as of 31 December 2004 and for the year then ended. This work has been finalized in 2006 with respect to sub-grade only. Accordingly, the Company adjusted its financial statements to reflect the results of the revaluation of this category of property (refer to "Correction of Prior Year Financial Statements" section above). With regard to other categories of property, plant and equipment, the Company is considering a revision of the date of revaluation so that the fair values of property, plant and equipment could be reported in its consolidated financial statements subsequent to 2006 by adjusting as needed the financial data for comparative financial statements as of 31 December 2006 and for the year then ended.

Impairment of property, plant and equipment

On the basis of the analysis of external and internal sources of information management concluded that certain indications of property, plant and equipment impairment existed as of 1 January 1999 and 31 December 1999. Accordingly, MPS estimated the recoverable amount of its property, plant and equipment as of 1 January 1999, which is the higher of net selling price and value in use. In the absence of sufficient and reliable information regarding market prices in respect of MPS's property, plant and equipment, value in use was used for the purpose of determining the recoverable amount of property, plant and equipment. In accordance with this method, MPS determined the recoverable amount of its property, plant and equipment as a value of future discounted cash flows from continuing use of property, plant and equipment. A 13% p.a. pre-tax discount rate was used in the calculation of the present value of future cash flows, as management believed that this rate reflected the current market assessments of the time value of money and the risks specific to the assets as of 1 January 1999.

2. Summary of Significant Accounting Policies (continued)

Property, Plant and Equipment (continued)

Impairment of property, plant and equipment (continued)

The value in use, as determined above, was lower than re-valued amount of property, plant and equipment as of 1 January 1999 as determined by a consortium of independent appraisal companies (refer above).

Based on these factors, an impairment loss related to the carrying value of the property, plant and equipment was recognised as of 1 January 1999 in the amount of Rbls 554,235. The impairment loss was recorded as a reduction to a previously established revaluation reserve.

The reduced carrying amount of property, plant and equipment is depreciated over the assets' remaining useful lives in respect of depreciable assets as of 1 January 1999 (see Depreciation of property, plant and equipment below).

At each balance sheet date in periods subsequent to the year ended 31 December 1999, MPS analyzed the recoverable amount of its property, plant and equipment to determine whether any revision had to be made to the impairment loss recognised as of 1 January 1999. Based on the results of such assessment management concluded that although certain indicators of improvement of the Company's performance existed as of the above dates, which, consequently, may be supportive of a conclusion that an impairment loss for its assets recognised in previous years as discussed above may no longer exist or might have decreased, the continuation of such indicators in the future could not be ascertained. Accordingly, management concluded that a revision (reversal) of the impairment loss previously recognized shall be limited only to the recognition of the effects of revaluation of sub-grade. This revision was recognized by adjusting the comparative financial information as of 1 January 2005 (refer to "Correction of Prior Year Financial Statements" comments above).

Due to significant uncertainties regarding future changes in the tariff-setting policy and further implementation of the Program of railway transportation restructuring, as more fully described in Note 23, a reliable basis for re-assessment of the recoverable amount of the Company's property, plant and equipment as of 31 December 2006 and 2005 was absent. Management believes that impairment loss recognised as of 1 January 1999 after adjustment for the effect of revaluation of sub-grade as discussed above is the best estimate in the current economic situation. Management cannot predict what effect changes in fiscal and political policies may have on the Company's remaining investment or ability to make future investments in property, plant and equipment, which may affect the recoverable amount of such investments. Management plans to revisit such an assessment at the time more certainty regarding factors outlined above exist and upon completion of property, plant and equipment revaluation. Accordingly, the amount of impairment loss may be revised.

As of 31 December 2006 and 2005 management identified a number of property items and construction-in-progress projects, which the Company decided to discontinue. An impairment loss was recognised with regard to such projects during 2006 and 2005 (refer to Note 3).

2. Summary of Significant Accounting Policies (continued)

Property, Plant and Equipment (continued)

Compensation for impairment

Compensation from third parties for items of property, plant and equipment that were impaired, lost or given up are reported in the statement of income when the compensation becomes receivable (refer to Note 3).

Depreciation of property, plant and equipment

For depreciable assets as of 1 January 1999, except for sub-grade, for which the date is 1 January 2004, - "the base assets", the new basis as determined above after taking into consideration the effects of inflation is depreciated on a straight-line basis over the asset's remaining useful life. Depreciation is charged to operating expenses in the respective period. Depreciation for base assets is charged over the assets' average remaining useful life since 1 January 1999 (for sub-grade – since 1 January 2004). Depreciation for property, plant and equipment acquired after 1 January 1999 (for sub-grade – after 1 January 2004) is charged over the assets' useful life when placed in operation. The overall remaining useful lives used to calculate depreciation starting from 1 January 1999 (for sub-grade – from 1 January 2004) are as follows (years):

Property, plant and equipment	Assets put into operation after 1 January 1999 (except for sub-grade for which the date is 1 January 2004)	Base assets
Buildings	80	46
Constructions	50	27
Sub-grade	100	60 - 85
Superstructure	21	10
Locomotives	25	7
Transport, passenger	28	10
Transport, cargo	25	7
Operating equipment	15	7
Non-production assets	61	44
Other fixed assets	20	14

The residual values, useful lives and depreciation methods are reviewed and adjusted as appropriate at each financial year end.

When assets are sold or retired, their carrying value is eliminated from the accounts and any gain or loss resulting from their disposal is included in the statement of income.

Land occupied by MPS's facilities was owned by the Russian Federation as of 31 December 2002 and was not included in Property, Plant and Equipment. In 2003, such land was contributed as in-kind contribution to the Company's newly established share capital (refer to Note 20) and, consequently, was included in Property, Plant and Equipment as of 31 December 2006 and 2005. The land is not depreciated.

2. Summary of Significant Accounting Policies (continued)

Property, Plant and Equipment (continued)

Depreciation of property, plant and equipment (continued)

Construction-in-progress comprises costs directly related to construction and acquisition of property, plant and equipment plus an appropriate allocation of directly attributable variable and fixed overheads that are incurred in construction. Construction-in-progress is depreciated once the asset is put into operation.

Property, plant and equipment - subsequent expenditures

Subsequent expenditures relating to an item of property, plant and equipment, which qualify for recognition as assets in accordance with provisions of IAS 16, are capitalized.

Major renewals and improvements are capitalised, and the assets replaced are retired. Gains and losses arising from the retirement of property, plant and equipment are included in the statement of income as incurred. When each major inspection is performed, its cost is recognised in the carrying amount of the plant and equipment as a replacement if the recognition criteria are satisfied.

Costs other than those referred to above are recognised as an expense when incurred.

Intangible Assets

Intangible assets (primarily software) are measured at cost. Intangible assets are recognised if it is probable that the future economic benefits attributable to the asset will flow to the enterprise. After initial recognition, intangible assets are measured at cost less accumulated amortization and any accumulated impairment losses. The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortized on a straight-line basis over the estimated useful lives of the related assets. An average useful life of 10 years is used in regard to all intangible assets. Amortisation periods and methods for intangible assets with finite useful lives are reviewed at least at each financial year-end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset is accounted for by changing the amortisation period or method, as appropriate, and treated as changes in accounting estimates.

Investments and Other Financial Assets

The Company's financial assets are classified as either financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, and available-for-sale investments, as appropriate. When financial assets are recognised initially, they are measured at fair value. The Company determines the classification of its financial assets after initial recognition. All purchases and sales of financial assets are recognised on the settlement date, which is the date that the asset is delivered to or by the Company.

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held-to-maturity when the Company has the positive intention and ability to hold to maturity. During the period the Company did not held any investments in this category.

2. Summary of Significant Accounting Policies (continued)

Investments and Other Financial Assets (continued)

Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term. Gains or losses on investments held for trading are recognised in income. During the period the Company did not hold any investments in this category.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are carried at amortised cost using the effective interest method. Gains and losses are recognised in income when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

Available-for-sale investments are those non-derivative financial assets that are designated as available-for-sale or are not classified in any other of the preceding categories. After initial recognition available-for-sale investments are measured at fair value with gains or losses being recognised as a separate component of equity until the investment is derecognised or until the investment is determined to be impaired, at which time the cumulative gain or loss previously reported in equity is included in the statement of income. Reversals of impairment losses in respect of equity instruments are not recognised in the statement of income. Impairment losses in respect of debt instruments are reversed through profit or loss if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss was recognised in the statement of income.

The fair values of investments that are actively traded in organised financial markets are determined by reference to quoted market bid prices at the close of business on the balance sheet date. For investments where there is no active market, fair value is generally determined using valuation techniques. Such techniques include using recent arm's length market transactions; reference to the current market value of another instrument, which is substantially the same; discounted cash flow analysis. When due to the nature of the investment, the reliable determination of its fair value is impracticable by applying valuation techniques, such investments are stated at cost.

1. Equity investments

The Company holds equity interests in various Russian legal entities (see Note 1). These investments are classified as available-for-sale.

Investments in unconsolidated subsidiaries and associated companies

Investments in companies not included in the consolidation are stated at cost in the consolidated balance sheet (refer to Note 4). When such cost, after considering effects of inflation, exceeded the amount of net assets of such subsidiaries and associated companies attributable to the Company, which were assessed on the basis of available financial information, limited generally to tax bases of assets and liabilities of such subsidiaries and associated companies, management considered such an excess as a permanent diminution in the value of the investment. Accordingly, the carrying amount of the investment was reduced to the estimated recoverable amount through a change to the statement of income.

2. Summary of Significant Accounting Policies (continued)

Investments and Other Financial Assets (continued)

Other equity investments

Other equity investments represent entities in which the Company holds less than 20% ownership interest and does not exert significant influence. Other equity investments are recorded at acquisition cost.

2. Other investments

Long-term loans originated by the Company that have a fixed maturity are stated at amortized cost using the effective interest rate method.

When there is a diminution in value of equity or other investments that is other than temporary, the carrying amount of such investments is reduced to the estimated recoverable amount.

Inventories

Inventories, which include materials, fuel and spare parts, are valued at the lower of cost as determined by the weighted average method or net realizable value. Inventories are reported net of reserves for slow moving or obsolete items.

Receivables

Receivables are stated at face value, after provision for doubtful accounts, which was estimated, based on known relevant factors affecting collectability. Ultimate losses may vary from the current estimates. These estimates are reviewed periodically, and as adjustments become necessary, they are reported as expense (income) in the period in which they become known.

Cash and Cash Equivalents

Cash consists of cash on hand and balances with banks. Cash equivalents comprise highly liquid investments with original maturities of three months or less.

Income Tax

Tax expense (tax income) is the aggregate amount included in the determination of profit or loss for the period in respect of current tax and deferred tax.

Current tax is the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period determined in accordance with the rules established by the taxation authorities, upon which income taxes are payable (recoverable).

Current tax liabilities (assets) for the current and prior periods are measured at the amount expected to be paid to (recovered from) the taxation authorities, using the tax rates (and tax laws) that have been enacted or substantially enacted by the balance sheet date.

2. Summary of Significant Accounting Policies (continued)

Income Tax (continued)

Deferred income taxes are determined utilizing the balance sheet liability method. This method gives consideration to the future tax consequences associated with the differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax bases.

Deferred income taxes are provided for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes except where the deferred income tax arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss. The principal temporary differences arise in respect of property, plant and equipment.

A deferred tax asset is recorded only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilized. Valuation allowances are provided for deferred tax assets that are not expected to be realised.

Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realized or the liability settled, based on tax rates that have been enacted or substantively enacted at the balance sheet date.

Deferred tax liabilities relating to undistributed earnings of subsidiaries and associated undertakings are provided when it is probable that such earnings will be remitted to the Company in the foreseeable future.

Current tax and deferred tax are charged or credited directly to equity if the tax relates to items that are credited or charged, in the same or a different period, directly to equity, for example, changes in carrying amount arising from the revaluation and impairment of property, plant and equipment.

Tax effects related to the revaluation of tax base of assets and liabilities are credited or charged to equity in case such revaluation for tax purposes is related to an accounting revaluation. Otherwise, tax effects are recognised in the statement of income.

Deferred tax assets and liabilities are not discounted.

Revenue and Expense Recognition

Revenues are recognised when it is probable that the economic benefits associated with the transaction will flow to the enterprise and the amount of revenues can be measured reliably.

Revenues and expenses are accounted for at the time the actual flow of related goods and services occurs and transfer of risks and rewards has been completed, regardless of when cash or its equivalent is received or paid, and are reported in the statement of income in the period to which they relate.

2. Summary of Significant Accounting Policies (continued)

Revenue and Expense Recognition (continued)

In respect of services related to cargo transportation, revenue is recognised by reference to the stage of completion of the transportation at the balance sheet date provided that the stage of completion of the transportation and the amount of revenue can be measured reliably. In the event that either of the conditions above is not met as of the balance sheet date, the recognition of revenue is deferred to the date when transportation is completed, i.e. cargo delivered to the place of destination. The stage of completion is determined as a percentage of services performed to date to total services to be performed.

Any deliveries, which have been previously collected from the clients, initiated and not completed as of the date of the accompanying consolidated financial statements are reported as liabilities in respect of services in transit under the payables caption in the accompanying consolidated balance sheets (refer to Note 10). The amount of liabilities is reduced for the amount of revenues recognised by reference to the stage of completion of the delivery.

Mutual Offset and Barter

A portion of sales is settled through mutual offset and barter arrangements. Mutual offset and barter transactions are measured at the fair value of the goods and services received or given up, whichever is most reliably measured.

Management estimated that for the year ended 31 December 2006 and 2005 not more than approximately 1% of the Company's sales were performed on a barter (offset) basis.

Borrowing Costs

Borrowing costs generally are expensed as incurred. Borrowing costs are capitalized if they are directly attributable to the acquisition, construction or production of a qualifying asset. Capitalisation of borrowing costs commences when the activities to prepare the asset are in progress and expenditures and borrowing costs are being incurred. Borrowing costs are capitalised until the assets are ready for their intended use. If the resulting carrying amount of the asset exceeds its recoverable amount, an impairment loss is recorded. Borrowing costs include the interest charge and other costs incurred in connection with the borrowing of funds.

Foreign Currency

Monetary assets and liabilities denominated in foreign currencies at the year-end are reported at the rates of exchange of the Central Bank of Russia prevailing at the year-end.

Any gain or loss arising from a change in exchange rates subsequent to the date of the transaction is included as an exchange gain or loss in the statement of income.

2. Summary of Significant Accounting Policies (continued)

Government Grants

Government grants related to income are recognised as income over the periods necessary to match them with the related cost, which they are intended to compensate. Grants received are treated as deferred income in the accompanying consolidated financial statements. Income relating to government grants is presented separately in the statement of income. Grants contributed towards the acquisition of property, plant and equipment are deducted from the cost of those assets.

Employee Benefits

Defined benefit plans

The Company operates two defined benefit pension plans. The obligation and cost of benefits under the plans are determined separately for each plan using the projected unit credit method. This method considers each year of service as giving rise to an additional unit of benefit entitlement and measures each unit separately to build up the final obligation. The cost of providing pensions is charged to the statement of income, so as to attribute the total pension cost over the service lives of employees in accordance with the benefit formula of the plan. This obligation is measured at the present value of estimated future cash flows using a discount rate that is similar to the interest on government bonds where the currency and terms of these bonds are consistent with the currency and estimated terms of the defined benefit obligation. Actuarial gains and losses are recognised as income or expense in full as they arise.

In addition, the Company provides certain other retirement and post retirement benefits to its employees. These benefits are unfunded.

Upon introduction of a new plan or improvement of an existing plan past service costs are recognised on a straight-line basis over the average period until the amended benefits become vested. To the extent that the benefits are already vested immediately, past service cost is immediately expensed.

Defined contribution plans

In addition to the defined benefit plans described above, the Company also sponsors a defined contribution plan for certain of its employees. The plan covers active employees and provides for contributions ranging from 1.2% to 7.9% of salary. The Company's contributions relating to the defined contribution plan are expensed in the year to which they relate.

State plan

In addition, the Company is legally obligated to make contributions to the Russian Pension Fund, managed by the Russian Federation Social Security (a multi-employer defined contribution plan). The Company's only obligation is to pay the contributions as they fall due. As such, the Company has no legal obligation to pay and does not guarantee any future benefits to its Russian employees. The Company's contributions to the Russian Pension Fund relating to defined contribution plans are expensed in the year to which they relate.

2. Summary of Significant Accounting Policies (continued)

Employee Benefits (continued)

State plan (continued)

Contribution to the Russian Pension Fund together with other social contributions are included within a unified social tax ("UST"), which is calculated by the application of a regressive rate from 26% to 2% to the annual gross remuneration of each employee. UST is allocated to three social funds (including the Russian Pension Fund), where the rate of contributions to the Russian Pension Fund varies from 20% to 2%, respectively, depending on the annual gross salary of each employee.

Leases

Finance leases, which transfer to the Company substantially all the risks and benefits incidental to ownership of the leased item, are capitalized at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income. Capitalized leased assets are depreciated on a straight-line basis over the shorter of the estimated useful life of the asset or the lease term unless there is a reasonable certainty that the Company will obtain ownership by the end of the lease term, in which case the assets are depreciated over their estimated useful lives.

Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. Operating lease payments are recognised as an expense in the statement of income on a straight-line basis over the lease term.

Research and Development Costs

Research costs are expensed as incurred. Development expenditure incurred on an individual project is carried forward when its future recoverability can reasonably be regarded as assured. Any expenditure carried forward is amortized over the period of expected future sales from the related project. The carrying value of development costs is reviewed for impairment annually when the asset is not yet in use or more frequently when an indication of impairment arises during the reporting year. The amount of research and development costs recognised by the Company in the statement of income for the year ended 31 December 2006 equated to 1,141 (2005: 1,248).

Provisions

A provision is recognised when the Company has a present obligation (legal or constructive) as a result of a past event and it is more likely than not that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligations. Provisions are reviewed at each balance sheet date and adjusted to reflect the current best estimate of management.

2. Summary of Significant Accounting Policies (continued)

Provisions (continued)

If the effect of time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognised as a borrowing cost.

Contingencies

Contingent liabilities are not recognised in the financial statements. They are disclosed unless the possibility of an outflow of resources embodying economic benefits is remote.

Contingent assets are not recognised in the financial statements. Where an inflow of economic benefits is probable, they are disclosed.

Contractual Commitments

Contractual commitments comprise legally binding trading or purchase agreements with stated amount, price and date or dates in the future.

The Company discloses significant contractual commitments in the Notes to the financial statements.

Subsequent Events

Post-year-end events that provide additional information about the Company's position at the balance sheet date (adjusting events) are reflected in the financial statements. Post-year-end events that are not adjusting events are disclosed in the notes when material.

Segment Reporting

The Company’s primary reporting format is business segments – cargo and passenger transportation. The operating businesses are organized and managed separately according to the nature of services provided, with each segment representing a strategic business unit that offers different products and serves different markets. Management believes that the Company operates in one geographical segment.

In addition, certain Company’s branches and subsidiaries provide auxiliary services (repair and maintenance, energy re-sale, telecommunication and construction services) to external customers and other companies within the Company. None of these operations are of a sufficient size to be reported separately.

Sales and other transactions between the reportable business segments are eliminated on consolidation.

Unallocated costs represent corporate expenses.

2. Summary of Significant Accounting Policies (continued)

Segment Reporting (continued)

Segment assets consist primarily of property, plant and equipment, inventories, receivables and operating cash, and mainly exclude investments, intangible assets, deferred tax assets, tax prepayments and assets used for the enterprise as a whole.

Segment liabilities comprise operating liabilities and exclude items such as taxation, certain corporate borrowings and other liabilities pertaining to the enterprise as a whole.

Capital expenditure comprises additions to property, plant and equipment. Impairment loss and provisions relate only to those charges made against allocated assets.

The following table presents revenue and profit and certain assets and liabilities information regarding the Company's business segments:

Year ended 31 December 2006

	Cargo	Passenger	Other	Elimination	Consolidated
Sales to third parties	673,894	118,426	85,568	–	877,888
Inter-segment sales	2,504	3,186	50,796	(56,486)	–
Total revenue	**676,398**	**121,612**	**136,364**	(56,486)	**877,888**
Segment expenses	(422,311)	(132,688)	(74,384)	–	(629,383)
Inter-segment expenses	(11,339)	(3,186)	(39,358)	53,883	–
Segment result	**242,748**	**(14,262)**	**22,622**	(2,603)	**248,505**
Unallocated corporate expenses					(53,779)
Operating profit					**194,726**
Finance charge	(3,954)	(2,431)	(503)	–	(6,888)
Unallocated interest expense and similar items, net					(45)
Changes in fair value and recoverable amounts of investments					940
Other income, net					12,968
Foreign exchange gain, net					1,537
Income tax					(63,432)
Net profit					**139,806**

2. Summary of Significant Accounting Policies (continued)

Segment Reporting (continued)

Year ended 31 December 2006 (continued)

	Cargo	Passenger	Other	Elimination	Consolidated
Segment assets	1,129,687	329,991	108,298	(2,603)	1,565,373
Inter-segment assets	3,385	476	9,852	(13,713)	–
Unallocated corporate assets					37,534
Consolidated total assets					**1,602,907**
Segment liabilities	162,492	50,393	20,919	–	233,804
Inter-segment liabilities	6,880	–	6,833	(13,713)	–
Unallocated corporate liabilities					132,765
Consolidated total liabilities					**366,569**
Capital expenditure	184,122	53,861	14,117	(2,603)	249,497
Fixed assets	1,059,244	313,530	82,179	(2,603)	1,452,350
Provision for impairment	(25,198)	(6,079)	–	–	(31,277)
Fixed assets, net of provision for impairment	1,034,046	307,451	82,179	(2,603)	1,421,073
Depreciation of fixed assets	(42,978)	(15,644)	(2,888)	–	(61,510)

Year ended 31 December 2005 (restated)

	Cargo	Passenger	Other	Total
Sales to third parties	584,716	94,578	69,955	749,249
Total revenue	**584,716**	**94,578**	**69,955**	**749,249**
Segment expenses	(397,429)	(117,099)	(63,951)	(578,479)
Segment result	**187,287**	**(22,521)**	**6,004**	**170,770**
Unallocated corporate expenses				(34,748)
Operating profit				**136,022**
Finance charge	(2,315)	(1,063)	(298)	(3,676)
Unallocated interest expense and similar items, net				(1,537)
Changes in fair value and recoverable amounts of investments				922
Other income, net				3,532
Foreign exchange (loss), net				(186)
Income tax				(44,237)
Net profit				**90,840**

2. Summary of Significant Accounting Policies (continued)

Segment Reporting (continued)

Year ended 31 December 2005 (restated) (continued)

	Cargo	Passenger	Other	Total
Segment assets	1,048,887	252,920	86,401	1,388,208
Unallocated corporate assets				54,180
Consolidated total assets				**1,442,388**
Segment liabilities	141,308	35,778	12,770	189,856
Unallocated corporate liabilities				155,025
Consolidated total liabilities				**344,881**
Capital expenditure	153,798	48,292	13,327	215,417
Fixed assets	974,806	236,768	65,347	1,276,921
Provision for impairment	(22,956)	(5,598)	–	(28,554)
Fixed assets, net of provision for impairment	951,850	231,170	65,347	1,248,367
Depreciation of fixed assets	(50,331)	(13,302)	(2,801)	(66,434)

3. Property, Plant and Equipment

Property, plant and equipment as of 31 December 2006 and 2005 comprised the following:

Carrying Value

	Balance as of 1 January 2006 (restated)	Additions	Disposals	Transfers	Balance as of 31 December 2006
Land	4,305	–	(4)	88	**4,389**
Buildings	118,935	327	(1,028)	12,544	**130,778**
Construction	262,582	3,621	(4,021)	29,360	**291,542**
Subgrade	360,083	3,318	(198)	5,144	**368,347**
Superstructure	164,547	31,627	(14,864)	6,664	**187,974**
Operating equipment	256,825	1,289	(2,931)	50,179	**305,362**
Locomotives	100,282	5,972	(8,301)	16,363	**114,316**
Transport, cargo	100,429	8,105	(5,571)	7,837	**110,800**
Transport, passenger	84,122	15,511	(3,787)	3,878	**99,724**
Non-production assets	18,213	–	–	–	**18,213**
Other fixed assets	54,234	1,626	(2,386)	7,420	**60,894**
Construction-in-progress	113,305	178,101	(1,851)	(139,477)	**150,078**
Less: provision for impairment	(28,554)	(5,342)	2,619	–	**(31,277)**
Total	**1,609,308**	**244,155**	**(42,323)**	**–**	**1,811,140**

3. Property, Plant and Equipment (continued)

Carrying Value (continued)

	Balance as of 1 January 2005 (restated)	Additions	Disposals	Transfers	Balance as of 31 December 2005 (restated)
Land	4,305	–	–	–	**4,305**
Buildings	102,647	327	(353)	16,314	**118,935**
Construction	228,694	5,459	(3,850)	32,279	**262,582**
Subgrade	351,205	2,735	(18)	6,161	**360,083**
Superstructure	146,468	26,097	(14,944)	6,926	**164,547**
Operating equipment	207,449	1,090	(5,641)	53,927	**256,825**
Locomotives	88,747	5,386	(5,577)	11,726	**100,282**
Transport, cargo	87,377	10,545	(3,890)	6,397	**100,429**
Transport, passenger	70,648	5,672	(5,896)	13,698	**84,122**
Non-production assets	18,213	–	–	–	**18,213**
Other fixed assets	48,116	56	(842)	6,904	**54,234**
Construction-in-progress	109,810	158,050	(223)	(154,332)	**113,305**
Less: provision for impairment	(22,915)	(5,639)	–	–	**(28,554)**
Total	**1,440,764**	**209,778**	**(41,234)**	**–**	**1,609,308**

Property, plant and equipment as of 31 December 2006 and 2005 include borrowing costs incurred in connection with the construction of certain property, plant and equipment. Actual borrowing costs capitalized as property, plant and equipment during 2006 using a capitalization rate of 6% equated to Rbls 3,047 (2005: Rbls 1,363 using capitalization rate of 2.6%).

Accumulated Depreciation

	Balance as of 1 January 2006, (restated)	Depreciation charge for the year	Accumulated depreciation on disposals	Balance as of 31 December 2006
Land	–	–	–	–
Buildings	(7,813)	(1,971)	134	**(9,650)**
Construction	(37,328)	(7,489)	1,134	**(43,683)**
Subgrade	(10,429)	(5,333)	7	**(15,755)**
Superstructure	(63,046)	(8,819)	11,126	**(60,739)**
Operating equipment	(70,144)	(20,479)	2,456	**(88,167)**
Locomotives	(61,754)	(2,156)	8,301	**(55,609)**
Transport, cargo	(65,877)	(4,217)	5,570	**(64,524)**
Transport, passenger	(26,029)	(6,292)	2,368	**(29,953)**
Non-production assets	(4,609)	(822)	–	**(5,431)**
Other fixed assets	(13,912)	(3,932)	1,288	**(16,556)**
Total	**(360,941)**	**(61,510)**	**32,384**	**(390,067)**

	Balance as of 1 January 2005 (restated)	Depreciation charge for the year	Accumulated depreciation on disposals	Balance as of 31 December 2005 (restated)
Land	–	–	–	–
Buildings	(6,176)	(1,688)	51	**(7,813)**
Construction	(32,359)	(6,917)	1,948	**(37,328)**
Subgrade	(5,182)	(5,247)	–	**(10,429)**
Superstructure	(61,609)	(8,867)	7,430	**(63,046)**
Operating equipment	(60,069)	(15,417)	5,342	**(70,144)**
Locomotives	(57,270)	(10,051)	5,567	**(61,754)**
Transport, cargo	(59,772)	(9,979)	3,874	**(65,877)**
Transport, passenger	(26,831)	(4,045)	4,847	**(26,029)**
Non-production assets	(3,788)	(821)	–	**(4,609)**
Other fixed assets	(11,255)	(3,402)	745	**(13,912)**
Total	**(324,311)**	**(66,434)**	**29,804**	**(360,941)**

3. Property, Plant and Equipment (continued)

Net Book Value

	Balance as of 31 December 2006	Balance as of 31 December 2005 (restated)	Balance as of 1 January 2005 (restated)
Land	**4,389**	4,305	4,305
Buildings	**121,128**	111,122	96,471
Construction	**247,859**	225,254	196,335
Subgrade	**352,592**	349,654	346,023
Superstructure	**127,235**	101,501	84,859
Operating equipment	**217,195**	186,681	147,380
Locomotives	**58,707**	38,528	31,478
Transport, cargo	**46,276**	34,552	27,604
Transport, passenger	**69,771**	58,093	43,817
Non-production assets	**12,782**	13,604	14,425
Other fixed assets	**44,338**	40,322	36,861
Construction-in-progress	**150,078**	113,305	109,810
Less: provision for impairment	**(31,277)**	(28,554)	(22,915)
Total	**1,421,073**	**1,248,367**	**1,116,453**

Included in property, plant and equipment are non-production assets in the net amount of Rbls 12,782 (2005: 13,604). Such assets primarily comprise social infrastructure assets and apartment buildings.

Management is of the opinion that expenditures incurred in respect of such objects qualify for capitalization on the basis of the fact that such expenditures are contributing indirectly to cash inflows to the Company through a reduction of cash outflows related to wages and salaries (refer to Note 2). Further, ongoing annual costs related to maintenance and operations of such assets are incurred by the Company.

Further, included in construction-in-progress are certain projects with the aggregate cost of Rbls 27,084 (2005: 24,988), which the Company abandoned. Further included in property, plant and equipment as of 31 December 2006 are items with the aggregate net carrying value of Rbls 4,193 (2005: 3,566), which the Company concluded to be impaired. A 100% provision for impairment was recognised by the Company with regard to such assets as of 31 December 2006 and 2005. The corresponding expense of Rbls 5,342 was reported in 2006 (2005: 5,639) and included in other operating expenses.

During 2006 RAO UES agreed to compensate the Company the losses for certain items of property, plant and equipment, which were impaired. The total amount of such compensation equated to Rbls 1 billion. The corresponding gain was reported in 2006 as a reduction of the impairment loss referred to above. The amount of compensation receivable as of 31 December 2006 equated to nil.

During the year ended 31 December 2006, the Company received grants in the amount of Rbls 1,056 (2005: 875) related to the acquisition of property, plant and equipment. These grants were recognised in the accompanying consolidated financial statements by deducting the grants in arriving at the carrying amounts of the assets. In addition, during 2006 and 2005 the Company was granted a free-of-charge right to use certain items of property, plant and equipment, which are owned by the government of Moscow.

3. Property, Plant and Equipment, Net (continued)

Net Book Value (continued)

Leased assets as of 31 December 2006 and 2005, included above where the Company is a lessee under a finance lease, comprised the following:

	2006	2005 (restated)
Cost – capitalized finance leases	**66,270**	38,669
Accumulated depreciation	**(3,593)**	(1,570)
Net book value	**62,677**	37,099

Included in leased assets above are assets with the aggregate cost of 33,401 as of 31 December 2006 (2005: 22,486), which were obtained from entities considered related to the Company (Note 22). Refer to Note 16 for further details regarding finance leases.

4. Investments

Investments as of 31 December 2006 and 2005 comprised the following (refer to Notes 1 and 2 for explanations regarding basis of reporting of the investments):

	2006	2005
Investments in unconsolidated subsidiaries (1)	**1,099**	1,908
Investments in associated undertakings (2)	**2,655**	2,692
Impairment reserve	**(2,344)**	(3,402)
Total investments	**1,410**	1,198

(1) Investments in unconsolidated subsidiaries as of 31 December 2006 comprised the following:

	Nature of business	% Equity interest	Historical cost	Related reserve	Carrying value
Transkat	Manufacturing	57%	377	(377)	–
Russkaya Troika	Transportation services	50%	236	–	236
Other			486	(267)	219
Total			**1,099**	**(644)**	**455**

Such investments as of 31 December 2005 comprised the following:

	Nature of business	% Equity interest	Historical cost	Related reserve	Carrying value
Lazur	Manufacturing	71%	1,010	(1,010)	–
Transkat	Manufacturing	57%	377	(377)	–
Russkaya Troika	Transportation services	50%	236	–	236
Other			285	(268)	17
Total			**1,908**	**(1,655)**	**253**

4. Investments (continued)

(2) Investments in associated undertakings as of 31 December 2006 comprised the following:

	Nature of business	% Equity interest	Historical cost	Related reserve	Carrying value
Raskom	Fiber-optic cables construction	46%	916	(916)	–
Ekza (A)	Manufacturing	25%	888	–	888
Other			851	(784)	67
Total			**2,655**	**(1,700)**	**955**

Such investments as of 31 December 2005 comprised the following:

(Restated)	**Nature of business**	**% Equity interest**	**Historical cost**	**Related reserve**	**Carrying value**
Raskom	Fiber-optic cables construction	46%	916	(916)	–
Ekza (A)	Manufacturing	25%	888	–	888
Other			888	(831)	57
Total			**2,692**	**(1,747)**	**945**

(A) Investment in Ekza represents an investment in a jointly controlled entity. Prior to 2005 uncertainty existed with respect of the Company's rights regarding its share in this joint venture. On this basis a 100% provision for diminution in value of this investment was recognised. In 2005 the parties to the joint venture completed determination of their shares in this entity. On this basis, the Company revised its assessment of the recoverability of its investment and reversed the provision for impairment previously recognised. Ekza commenced its operations in late 2005.

Reversal of provision for diminution in value of investments in the amount of Rbls 48 and Rbls 883 was reported in the consolidated statements of income for the years ended 31 December 2006 and 2005, respectively.

During 2006, the Company continued disposing of a number of its investments in subsidiaries and associated undertakings. The proceeds from the disposal of these investments equated to nil in both 2006 and 2005.

5. Other Investments

Other investments as of 31 December 2006 and 2005 comprised the following:

	2006	**2005**
Other equity investments (1)	**515**	316
Other investments (2)	**8,233**	2,977
Impairment reserve	**(1,107)**	(1,999)
Total other investments	**7,641**	1,294

5. Other Investments (continued)

(1) Other equity investments as of 31 December 2006 comprised the following:

	Nature of business	% Equity interest	Cost	Related reserve	Carrying value
OAO Ust-Luga	Sea port	9%	185	–	185
Muromsky Strelochniy Zavod	Manufacturing	13%	112	(112)	–
Other			218	(198)	20
Total			**515**	**(310)**	**205**

Such investments as of 31 December 2005 comprised the following:

	Nature of business	% Equity interest	Cost	Related reserve	Carrying value
Muromsky Strelochniy Zavod	Manufacturing	13%	112	(112)	–
Other			204	(195)	9
Total			**316**	**(307)**	**9**

(2) Other investments as of 31 December 2006 and 2005 comprised the following:

	2006			2005		
	Cost	Related reserve	Carrying value	Cost	Related reserve	Carrying value
Bank deposits, including interest accrued (A)	**6,104**	**–**	**6,104**	–	–	–
Loans Issued	**1,240**	**(632)**	**608**	**1,527**	(1,527)	–
Promissory notes FK "Locomotive" (refer to Note 1)		**–**		580	–	580
Promissory notes ZAO "Baltiyskiy bank"	**–**	**–**	**–**	371	–	371
Other	**889**	**(165)**	**724**	499	(165)	334
Total	**8,233**	**(797)**	**7,436**	2,977	(1,692)	1,285

(A) Bank deposits as of 31 December 2006 are comprised of long-term deposits in TransCreditBank amounting to Rbls 5,101 (2005: nil) and Bank Vozrozhdenije amounting to Rbls 1,003 (2005: nil). Interest for such deposits varies from 8.5% to 8.75%. The deposits mature in 2008.

Reversal of provision for diminution in value of investments in the amount of Rbls 892 and Rbls 39 was reported in the consolidated statement of income for the years ended 31 December 2006 and 2005, respectively.

6. Inventories

Inventories as of 31 December 2006 and 2005 comprised the following:

	2006	2005
Raw materials	**22,927**	28,527
Fuel and lubricants	**5,771**	4,407
Spare parts and construction materials	**21,312**	10,569
Merchandise inventories	**2,148**	1,318
Other	**5,238**	4,988
Total	**57,396**	49,809
Less: provision for obsolete and damaged inventory	**(2,764)**	(4,339)
Total inventories, net	**54,632**	45,470

7. Prepayments and Other Current Assets

Prepayments and other current assets as of 31 December 2006 and 2005 comprised the following:

	2006	2005
Input VAT	**33,771**	61,293
Less: Valuation allowance (A)	**(3,168)**	(2,680)
	30,603	58,613
Advances paid to suppliers	**9,032**	4,933
Less: provision for doubtful advances	**(375)**	(470)
	8,657	4,463
Bank deposits, including interest accrued (B)	**7,879**	–
Prepaid other taxes	**2,402**	2,453
Other current assets	**3,260**	2,859
Total prepayments and other current assets	**52,801**	68,388

(A) 100% provision was recognised by the Company as of 31 December 2006 and 2005 with respect of input VAT related to construction-in-progress projects abandoned (refer to Note 3).

(B) Bank deposits as of 31 December 2006 comprised short-term deposits placed with Mezhdunarodny Promyshlenny Bank of Rbls 4,000 (2005: nil), AKB Promsvjazbank of Rbls 2,500 (2005: nil), AKB Absolut bank of Rbls 1,300 (2005: nil). Interest on such deposits varies from 2.25% to 7.5%. The deposits mature in January – March 2007.

8. Receivables

Receivables as of 31 December 2006 and 2005 comprised the following:

	2006	2005
Trade receivables (1)	**4,556**	4,063
Other accounts receivable (2)	**16,514**	11,519
Total receivables	**21,070**	15,582

(1) Trade receivables as of 31 December 2006 and 2005 comprised the following:

	2006	2005
Trade receivables	**12,552**	6,469
Less: provision for doubtful accounts	**(7,996)**	(2,406)
Total trade receivables	**4,556**	4,063

(2) Other accounts receivable as of 31 December 2006 and 2005 comprised the following:

	2006	2005
Other accounts receivable	**20,207**	15,469
Less: provision for doubtful accounts	**(3,693)**	(3,950)
Total other accounts receivable	**16,514**	11,519

Bad debt expense of Rbls 6,476 was recognised during the year ended 31 December 2006 (2005: 285). The above mentioned amount of bad debt expense contains direct write-off of accounts receivable of Rbls 1,145 (2005: nil).

9. Cash and Cash Equivalents

Cash and cash equivalents as of 31 December 2006 and 2005 comprised the following:

	2006	2005
Cash in local currency	**11,842**	11,639
Bank deposits and other cash equivalents (A)	**5,054**	126
Cash in foreign currencies	**527**	435
Total cash and cash equivalents	**17,423**	12,200

(A) Bank deposits and other cash equivalents as of 31 December 2006 included short-term deposits placed with AKB Evrofinance Mosnarbank of Rbls 3,000 (2005: nil), TransCreditBank of Rbls 1,000 (2005: nil) and short-term promissory notes of LLC Brokerskaya Company Region of Rbls 1,000 (2005: nil). Interest on such deposits varies from 6% to 8%. Interest on promissory notes equals to 8%. The deposits mature in January – February 2007.

10. Payables

Payables as of 31 December 2006 and 2005 comprised the following:

	2006	2005
Trade payables	**46,325**	30,649
Liabilities to customers	**32,515**	33,288
Other accounts payable	**16,449**	11,067
Total payables	**95,289**	75,004

Liabilities to customers as of 31 December 2006 and 2005 comprised the following:

	2006	2005
Advances received from customers	**26,599**	28,417
Services in transit	**5,916**	4,871
Total liabilities to customers	**32,515**	33,288

11. Taxes and Similar Charges Payable

Taxes and similar charges payable as of 31 December 2006 and 2005 comprised the following:

	2006	2005
VAT	**9,145**	14,464
Settlements with social funds	**6,729**	4,961
Property tax	**4,909**	4,028
Personal income tax	**1,878**	1,744
Other taxes	**1,782**	807
Total taxes and similar charges payable	**24,443**	26,004

12. Long-Term and Short-Term Borrowings

Short-term Borrowings

Short-term borrowings as of 31 December 2006 and 2005 comprised the following:

	2006	2005
Bonds (E)	**14,000**	–
Bank loans (A)	**1,728**	16,809
Current portion of EBRD loan / MPS (B)	**296**	1,206
Other (C)	**1,163**	77
Total short-term borrowings	**17,187**	18,092

(A) Bank loans as of 31 December 2006 and 2005 comprise short-term loans obtained from various banks, including loans obtained from International Moscow Bank of Rbls 660

12. Long-Term and Short-Term Borrowings (continued)

Short-term Borrowings (continued)

(2005: 1,004), Dresdner Bank of Rbls 147 (2005: 2,511) and CITI Bank of Rbls 133 (2005: nil).

Further, included in short-term loans as of 31 December 2006 are loans from TransCreditBank of Rbls 300 (2005: nil). As of 31 December 2005 short-term loans further included loans from Gazprombank of Rbls 8,765, Sberbank of Russia of Rbls 3,503. These banks are considered related parties to the Company (refer to Note 22).

For the year ended 31 December 2006 interest rates on such loans varied from 5.3% to 8.3% (2005: 5.5% to 7.5%).

(B) Loan from European Bank for Reconstruction and Development (the EBRD) / MPS.

The EBRD / MPS loan as of 31 December 2006 and 2005 represents a US dollar denominated loan obtained by MPS under a credit line agreement signed between the government of the Russian Federation and the EBRD in 1996, which was then assigned to MPS. As a result of reorganization of MPS (refer to Note 1), RZD assumed responsibility previously reported by MPS, including the outstanding balance of the EBRD loan referred to above (on terms and conditions of the original loan agreement between MPS and the EBRD). In 2004 the Company signed additional agreement with MPS, Ministry of Finance and Federal Agency on Railroad Transport, under which MPS obligations and rights under the EBRD loan agreement referred to above were formally re-assigned to RZD.

The total amount of the credit line provided by the EBRD equates to USD 120,130 thousand. In 2004 the credit line was reduced at the request of the Company to USD 110,163 thousand. The outstanding balance of the loan drawn by the Company as of 31 December 2006 including accrued interest equated to USD 31,618 thousand (Rbls 833 at the exchange rate as of 31 December 2006) (2005: USD 41,884 (Rbls 1,206 at the exchange rate as of 31 December 2005)). The interest rate is LIBOR + 0.75% (LIBOR equated to 5.3% and 4.8% as of 31 December 2006 and 2005, respectively). The loan is not secured.

Repayments of the above debt under the original terms of the credit line agreement were scheduled as of 31 December as follows:

	2006 Principal amount		**2005 Principal amount**	
	in original currency (USD'000)	**(millions of Rubles)**	**in original currency (USD'000)**	**(millions of Rubles)**
2006	**–**	**–**	10,200	294
2007	**10,200**	**269**	10,200	294
2008 and thereafter	**20,400**	**537**	20,400	587
Total	**30,600**	**806**	40,800	1,175

12. Long-Term and Short-Term Borrowings (continued)

Short-term Borrowings (continued)

As of 31 December 2005, the Company did not comply with certain covenants stipulated in the loan agreement with the EBRD. Under provisions of the loan agreement referred to above, EBRD had the right to demand immediate repayment of the full outstanding amount of the loan.

During 2005 the Company did not receive any formal notice from EBRD waiving its right to demand the immediate repayment of the loan. On this basis, the whole amount of the loan outstanding as of 31 December 2005 was classified as short-term. During 2006 the EBRD waived the applicability of certain covenants stipulated in the loan agreements and confirmed, as a result, the absence of breaches of these covenants. Accordingly, the Company amended the classification of the loan in its financial statements and reported amounts payable over period exceeding twelve months after 31 December 2006 as long-term loans.

(C) Other short-term borrowings as of 31 December 2006 include loans from ZAO "TFK", considered related to the Company (please, refer to Note 22), of Rbls 586, promissory notes of Transtelecom of Rbls 505, purchased by International Moscow Bank, and other minor loans of Rbls 72. For the year ended 31 December 2006 interest rates on such loans varied from 12% to 18%.

Long-term Borrowings

2006

The outstanding balances of long-term borrowings as of 31 December 2006 comprised the following:

	Original currency	Amount in original currency	Interest rate	Maturity	Amount in Rbls
Syndicated bank loans (D)					
Tranche A	USD	300 mln	(D)	(D)	7,899
Tranche B	USD	300 mln	(D)	(D)	7,899
					15,798
Bonds (E)	RUR	29 bln	(E)	(E)	29,000
FinancePromMarket	RUR	623 mln	18%	2008	623
Long-term portion of EBRD loan / MPS (B)	USD	20 mln	(B)	(B)	537
CITI BANK	CHF	24 mln	LIBOR+0.65%	2011	505
ConsultFinance	RUR	500 mln	11.75%	2008	500
Promissory notes			6-11.5%	2008 - 2009	422
Other					1,040
Total					**48,425**

12. Long-Term and Short-Term Borrowings (continued)

Long-term Borrowings (continued)

2005

The outstanding balances of long-term borrowings as of 31 December 2005 comprised the following:

	Original currency	Amount in original currency	Amount in Rbls
Syndicated bank loans (D)			
Tranche A	USD	300 mln	8,635
Tranche B	USD	300 mln	8,635
			17,270
Bonds (E)			33,000
Other			469
Total			**50,739**

(D) In October 2005 the Company obtained a US dollar denominated unsecured loan from a consortium of international banks led by Barclays Capital, Dresdner Kleinwort Wasserstein, HSBC Bank plc, Raiffeisen Zentralbank Osterreich AG. The loan attracts interest calculated as an aggregate of MARGIN (0.75% per annum with respect of Tranche A and 0.90% per annum with respect of Tranche B), LIBOR and mandatory cost (additional interest as calculated by the loan agent in accordance with the provisions of the agreement). The effective interest rate comprised 5.89% (2005: 5.28%) for Tranche A and 6.04% (2005: 5.43%) for Tranche B for the year ended 31 December 2006.

The loan is repayable as follows:

- Tranche A – in three years from the date of its utilization;
- Tranche B – in five equal semi-annual installments commencing 36 months after the date of the agreement.

The loan agreement provides for certain covenants (including financial ratios), which the Company is obligated to comply with. Non-compliance with these covenants gives the lenders the right to demand immediate repayment of the loan.

The amount of accrued interest on the loan equated to Rbls 147 as of 31 December 2006 (2005: nil).

12. Long-Term and Short-Term Borrowings (continued)

Long-term Borrowings (continued)

(E) The aggregate amount of bonds outstanding as of 31 December 2006 comprised bonds with the face value of Rbls 1 thousand of Series 2 and 3 issued in 2004, Series 4, 6 and 7 issued in 2005, and Series 05 issued in 2006 as follows:

	Amount	Coupon rate (%)	Maturity
Series 02	4,000	7.75	2007
Series 04	10,000	6.59	2007
	14,000		
Series 03	4,000	8.33	2009
Series 05	10,000	6.67	2009
Series 06	10,000	7.35	2010
Series 07	5,000	7.55	2012
	29,000		

Coupon interest is paid semi-annually. The repayment of the Company's bonds of series 04-07 is guaranteed by Trans-Invest LLC, a subsidiary of non-state pension Fund "Blagosostoyanie", which is a related party (refer to Note 22). The repayment of the Company's bonds of series 02-03 is guaranteed by the Company's 100% subsidiary – KRP-Invest. Due to the fact that financial position and results of operations of this subsidiary are immaterial, investment in this subsidiary of Rbls 14 was reported in the financial statements as of 31 December 2006 and 2005 at cost, net of provision for diminution in value.

The amount of accrued interest on these bonds equated to Rbls 511 as of 31 December 2006 (2005: 215).

13. Other Long-Term Debt

Other long-term debt as of 31 December 2006 and 2005 comprised the following:

	2006	2005
Long-term tax liabilities	**2,767**	13,067
Other	**86**	244
Total other long-term debt	**2,853**	13,311

In December 2001 the Government of the Russian Federation issued a decree allowing MPS to restructure the repayment schedule of a portion of its tax liabilities upon signing an agreement concerning such restructuring with the tax authorities. These agreements allowed individual departments of MPS and, pursuant to the reorganisation discussed in Note 1, of the Company, as defined in Note 1, to defer the repayment of tax obligations accumulated as of 1 December 2001 under the provision that tax liabilities arising in periods subsequent to the date referred to above and the agreed portion of the restructured tax debts are paid timely as they fall due. On this basis the amount of Rbls 2,767 (2005: 13,067) was reported in the accompanying consolidated balance sheet as other long-term debt.

13. Other Long-Term Debt (continued)

The restructured tax liability as of 31 December 2006 and 2005 comprised the following:

	2006	2005
VAT	–	7,928
Income tax	**65**	1,921
Other taxes	**2,702**	3,218
Restructured tax liability	**2,767**	13,067

Under the terms of the Government Decree referred to above, the restructured tax liability bears interest of 5.5% per annum payable in quarterly installments.

Repayments of these obligations are scheduled as follows:

	2006	2005
2007	–	–
2008 and thereafter	**2,767**	13,067
Total	**2,767**	13,067

The tax restructuring agreements referred to above specify that in the event of the Company's non-compliance with the repayment term referred to above and further, in case of delays of settlement of the current tax liabilities, the tax authorities have the right to call the full amount of the restructured tax liabilities for immediate repayment.

The balance outstanding as of 31 December 2006 and 2005 comprised only restructured tax related fines and penalties. The Government Decree referred to above specifies that in case of repayment of the principal amount of the restructured tax liabilities in compliance with the agreed upon repayment schedule, the restructured tax related fines and penalties are to be forgiven as consented to by the tax authorities. During 2006 approximately Rbls 330 were repaid by the Company and Rbls 9,970 (2005: 7,595) of the restructured fines and penalties were forgiven. A corresponding gain is included in the statement of income for the year ended 31 December 2006 and 2005 and is reported as taxes other than income tax in the amount of Rbls 8,276 (2005: 4,491), and income tax in the amount of Rbls 1,694 (2005: 3,104).

With regard to the residual balance of deferred fines and penalties of Rbls 2,767 (2005: 13,067) the Company believes that all conditions set forth by the Government Decree above for deferred fines and penalties forgiveness have been met and expects to receive a confirmation from the tax authorities on such forgiveness. In the absence of such a confirmation as of 31 December 2006, the Company did not recognise any gain resulting from extinguishment of this debt and reported fines and penalties above as other long-term debt.

Although, some uncertainty exists as to whether the gain on such forgiveness recognised in 2005 is subject to income tax, management believes that the probability of these gains being considered taxable is remote. Accordingly, no related provision for income tax was recognised as of 31 December 2005. Subsequent to the change in tax legislation effective from 1 January 2006, the gains on forgiveness of the above amount are not subject to income tax.

14. Pension Plans and Employee Benefits

The Company and its subsidiaries provide defined benefit and defined contribution pension plans covering substantially all of its employees, requiring contributions to be made to a separately administered non-state pension fund "Blagosostoyanie" and not-for-profit fund "Pochet". Pension entitlements are accrued using the projected unit credit method.

In order to be entitled to pension through the non-state pension fund "Blagosostoyanie" a person should meet the following criteria:

1) active participants in defined benefit plan[(A)] born before 1967 – 15 years of past service with the Company or 10 years of participation in the defined benefit plan;
2) all other employees who are not active participants in the defined benefit plan[(A)] referred to above or in defined contribution plans:
   i. joined pension plan before 1 January 2005 – 15 years of past service with the Company, including 5 years of continuing service before retirement;
   ii. joined pension plan after 1 January 2005 – 15 – 20 years (15 years for women, 20 years for men) of continuing service before retirement;
3) employees (including active participants in defined benefit plan[(A)]) should retire from the Company.

(A) An active participant in defined benefit plan is a person, making contributions to the pension plan at his/her own expense. Such contributions are matched by the Company.

Not-for-profit fund "Pochet" provides pensions to employees of the Company retired before the defined benefit plans provided through the non-state pension fund "Blagosostoyanie" referred to above were introduced.

Benefits accrued through pension plan administered by non-state pension fund "Blagosostoyanie" are partially funded, whilst benefits administered by not-for-profit fund "Pochet" are unfunded.

In addition, the Company and its subsidiaries provides other retirement and post employment benefits to its employees, which comprise a once per year free of charge transportation on long-distance trains and one-time bonus on retirement ranging from 1 to 6 monthly salaries and depending on the duration of the service period and some other. These benefits are unfunded.

Similarly to pension plans above, entitlements to such additional benefits are accrued using the projected unit credit method. During the years ended 31 December 2006 and 2005 the Company increased some of these benefits. Such benefits which vested immediately were recognised as past service in the statement of income for the years ended 31 December 2006 and 2005.

There were approximately 1.3 million employees eligible to some part of the post employment and post retirement benefit program of the Company as of both 31 December 2006 and 2005, of which 207,670 and 277,000 employees were considered active participants in the defined benefit pension plan as at 31 December 2006 and 31 December 2005. In addition, there are approximately 545,402 and 608,000 retired employees eligible for the post retirement benefit program of the Company provided through not-for-profit fund "Pochet" as of 31 December 2006 and 2005.

14. Pension Plans and Employee Benefits (continued)

The amounts recognised in the consolidated balance sheet are as follows:

As of 31 December 2006:

	Blago-sostoyanie	Pochet	Other post-employment benefits	Total
Present value of defined benefit obligations	38,761	15,279	31,505	**85,545**
Fair value of plan assets	(4,442)	–	–	**(4,442)**
Present value of unfunded defined benefit obligations	34,319	15,279	31,505	**81,103**
Unrecognised past service cost	(8,996)	–	(1,838)	**(10,834)**
Net pension liability in the balance sheet	**25,323**	**15,279**	**29,667**	**70,269**

As of 31 December 2005 (restated):

	Blago-sostoyanie	Pochet	Other post-employment benefits	Total
Present value of defined benefit obligations	44,711	15,815	24,139	**84,665**
Fair value of plan assets	(2,941)	–	–	**(2,941)**
Present value of unfunded defined benefit obligations	41,770	15,815	24,139	**81,724**
Unrecognised past service cost	(12,685)	–	(1,049)	**(13,734)**
Net pension liability in the balance sheet	**29,085**	**15,815**	**23,090**	**67,990**

The amounts recognised in the consolidated statement of income, which are included in "Wages, salaries and related contributions", are as follows:

For the year ended 31 December 2006:

	Blago-sostoyanie	Pochet	Other post-employment benefits	Total
Current service cost	1,763	–	1,174	**2,937**
Interest on benefit obligations	3,020	1,116	2,278	**6,414**
Expected return on plan assets	(317)	–	–	**(317)**
Actuarial loss, net	776	655	2,117	**3,548**
Past service cost vested immediately	–	–	3,055	**3,055**
Amortization of past service cost	4,413	–	236	**4,649**
Net expense for the year	**9,655**	**1,771**	**8,860**	**20,286**

Actual return on plan assets: *391*

14. Pension Plans and Employee Benefits (continued)

For the year ended 31 December 2005 (as previously reported, refer to Note 2):

	Blago-sostoyanie	Pochet	Other post-employment benefits	Total
Current service cost	2,840	–	1,236	**4,076**
Interest on benefit obligations	2,966	1,391	1,626	**5,983**
Expected return on plan assets	(205)	–	–	**(205)**
Actuarial loss	1,771	36	–	**1,807**
Loss on settlement	4,055	–	–	**4,055**
Amortization of past service cost	3,157	–	808	**3,965**
Net expense for the year	**14,584**	**1,427**	**3,670**	**19,681**

Actual return on plan assets: *205*

Movements in the net liability recognised in the consolidated balance sheets are as follows:

		2005 (restated)		
	2006	As reported previously	Cumulative adjustment (Note 2)	Restated
Net liability at the 1 January	**67,990**	47,393		
Net expense recognized in the statement of income	**20,286**	19,681		
Contributions	**(18,007)**	(13,330)		
Net liability at 31 December	**70,269**	53,744	14,246	67,990

Movements in the net assets of defined benefit pension plans during 2006 and 2005 were as follows:

	2006	2005
Fair value of plan assets at 1 January	**2,941**	1,872
Actual return on plan assets	**391**	205
Employer contributions	**18,007**	13,330
Settlement of liability	**(12,309)**	(8,375)
Benefits paid	**(4,588)**	(4,091)
Fair value of plan assets at 31 December	**4,442**	2,941

The Company expects to contribute approximately Rbls 16 bln to its defined benefit pension plans in 2007.

14. Pension Plans and Employee Benefits (continued)

The major categories of plan assets administered by non-state pension fund "Blagosostoyanie" as a percentage of the fair value of total plan assets were as follows as of 31 December 2006 and 2005:

	2006 (%)	2005 (%)
Bank deposits	**22%**	34%
Corporate bonds of Russian legal entities	**37%**	26%
Promissory notes of Russian legal entities	**30%**	29%
Moscow City Government bonds	**7%**	8%
Other	**4%**	3%

As of 31 December 2006 and 2005 actuarial assumptions used were as follows:

	2006	2005 (restated)
Discount rate	**7.5%**	8.52%
Rate used for calculation of annuity value	**4.00%**	4.00%
Average remaining working life	**19 years**	19 years
Expected return on plan assets	**8.52%**	14.00%
Mortality tables	**Year 1994**	Year 1994

The Company further assumed that salary will increase in future in line with inflation rate.

The overall expected rate of return on assets is determined based on the market prices prevailing on that date, applicable to the period over which the obligations are to be settled.

The decrease in discount rate and expected return on assets in 2006, resulted from a decrease noted in 2006 in the market yields of high quality corporate and government bonds. The aggregate effect of a decrease in the discount rate of Rbls 3,840 is reported as actuarial loss in the statement of income for the year ended 31 December 2006.

Amounts for the current and previous three periods are presented in the table below, as follows:

Blagosostoyanie

		2005			
	2006	Restated - (A)	As previously reported	2004 (A)	2003 (A)
Present value of defined benefit obligations	**38,761**	44,711	34,853	35,650	34,617
Fair value of plan assets	**(4,442)**	(2,941)	(2,941)	(1,872)	(867)
Present value of unfunded defined benefit obligations	**34,319**	41,770	31,912	33,778	33,750
Experience adjustment on plan liabilities: (gain)/loss	**(264)**	(A)	1,771	–	(A)
Experience adjustment on plan assets: (gain)	**(74)**	–	–	–	(A)

14. Pension Plans and Employee Benefits (continued)

Pochet

		2005			
	2006	**Restated - (A)**	**As previously reported**	**2004 (A)**	**2003 (A)**
Present value of defined benefit obligations	15,279	15,815	15,815	16,837	16,908
Fair value of plan assets	–	–	–	–	–
Present value of unfunded defined benefit obligations	15,279	15,815	15,815	16,837	16,908
Experience adjustment on plan liabilities: (gain)/loss	(78)	36	36	266	(A)

Other post-employment benefits

		2005			
	2006	**Restated - (A)**	**As previously reported**	**2004 (A)**	**2003 (A)**
Present value of defined benefit obligations	31,505	24,139	20,525	17,645	17,043
Fair value of plan assets	–	–	–	–	–
Present value of unfunded defined benefit obligations	31,505	24,139	20,525	17,645	17,043
Experience adjustment on plan liabilities: loss	50	(A)	–	13	(A)

(A) The Company does not have reliable data for periods prior to 2004 regarding the number of employees eligible for the long-term benefits and the definition of specific benefits attributable to each of the Company's employee. Accordingly, allocation of defined benefit obligations to periods prior to the year ended 31 December 2004 has not been made. Further, as discussed in Note 2 the Company discovered an error in the application of the projected unit credit method in periods prior to 2006. Management resolved that it is impracticable to determine the period-specific effects of this error on comparative information presented. Accordingly, the cumulative effect of this error was recognized by restating the balance of defined benefit liabilities as of 31 December 2005.

The Company introduced a number of changes to both defined benefit and defined contribution pension plans effective from 1 January 2007. These changes are aimed at (i) stimulating employees to become active participants to the plans (as defined above) by softening the qualification requirements and (ii) reducing the number of employees participating in the defined benefit plans by limiting the number of employees qualifying for participation in the defined benefit plans. These changes include, among other, the following:

- reduction of the period of active participation in the pension plan from 10 to 5 years;
- restriction of the period over which employees can join the defined benefit plan.

15. Accrued and Other Current Liabilities

Accrued and other current liabilities as of 31 December 2006 and 2005 comprised the following:

	2006	2005
Provision for tax liabilities (Note 23)	**32,955**	37,175
Settlements with employees	**21,089**	17,124
Provision for legal claims (Note 23)	**1,255**	3,849
Provision for social infrastructure assets transferred to municipalities (Note 1)	**606**	2,515
Other liabilities	**1,605**	1,806
Total accrued and other liabilities	**57,510**	62,469

16. Finance Liabilities

During 2006 and 2005, the Company entered into several finance lease agreements for cargo and passenger transport, locomotives and other operating equipment. The lease agreements are for periods from 1.5 to 9 years with the effective interest rate varying from 8% to 35% p.a. Future minimum lease payments together with the present value of the net minimum lease payments as of 31 December 2006 and 2005 are as follows:

	2006	2005
Finance lease liabilities – minimum lease payments		
Not later than 1 year	**16,320**	10,230
Later than 1 year and not later than 5 years	**47,483**	28,869
Later than 5 years	**8,792**	6,176
Total minimum lease payments	**72,595**	45,275
Less: interest	**(22,199)**	(15,548)
Present value of minimum lease payments	**50,396**	29,727
Representing lease liabilities		
Current	**9,575**	5,557
Non-current	**40,821**	24,170

Depreciation of property, plant and equipment under these finance lease agreements for 2006 was equal to Rbls 2,023 (2005: 1,025) (see also Note 3). Finance charges for the year ended 31 December 2006 amounted to Rbls 6,888 (2005: 3,676) and are included in "Interest expense and similar items, net" in the accompanying consolidated statement of income.

The aggregate amount of finance lease liabilities on agreements signed with entities considered related to the Company's related parties disclosed in Note 22 equated to 24,278 as of 31 December 2006 (2005: 17,217). Effective interest rate on these agreements varies from 14% to 29%.

17. Taxes Other than Income Tax, Net

Included in the amount of taxes other than income tax expense, net for the years ended 31 December 2006 and 2005 are the amounts of Rbls 4,220 and Rbls 16,335, which represent a reversal of provision for tax liabilities recognised by the Company (refer to Note 15).

18. Social Expenses

Social expenses for the years ended 31 December 2006 and 2005 comprised the following:

	2006	2005
Expenses of healthcare and educational departments	**3,435**	2,345
Social assets maintenance, net (refer to Note 1)	**175**	4,005
Other miscellaneous social expenses	**632**	2,231
Total social expenses, net	**4,242**	8,581

The amount of social assets maintenance expenses for the year ended 31 December 2006 is stated net of reversal of a provision previously recognized of Rbls 1,584 (refer to Note 15).

Further, for the purposes of the presentation in the accompanying consolidated financial statements, certain other social expenses were classified and reported based on their nature under appropriate headings in the accompanying consolidated statements of income.

19. Other Income/(Expenses), Net

Other income/(expenses), net for the years ended 31 December 2006 and 2005 comprised the following:

	2006	2005 (restated)
Reversal of provision for legal claims (Note 23)	**2,594**	2,170
Gain / (loss) on disposals of property, plant and equipment, net	**91**	(5,267)
Gain on disposal of inventory, net	**603**	842
Other income, net	**9,680**	5,787
Total other income/(expenses), net	**12,968**	3,532

Included in other income, net for the year ended 31 December 2006 is the amount of Rbls 7,398 (2005: 8,256), which represents income from rent of cargo cars. Further included in other income, net for the year ended 31 December 2006 is the amount of penalties charged by the Company to its customers of Rbls 5,620 (2005: 5,655).

20. Equity

The share capital of the Company as of 31 December 2006 and 2005 consists of 1,535,700,000 authorized, issued and outstanding common shares with par value of Rbls 1 thousand. The sole shareholder of the Company is the Russian government, which is allowed one vote per share.

The issued shares were paid through a contribution of net assets previously owned by MPS and further a contribution of land of Rbls 4,305 (refer to Note 3).

All common shares are eligible for distribution of earnings available in accordance with the Russian statutory accounting regulations. Dividends may only be declared from accumulated undistributed and unreserved earnings as shown in the Russian statutory financial statements. Dividends are subject to a 9% (2005: 9%) withholding tax. Approximately Rbls 26,410 and Rbls 9,751 were available for dividends as of 31 December 2006 and 2005, respectively, under the Russian statutory accounting regulations. The amount of dividends declared and paid by the Company in 2006 equated to Rbls 975 (2005: 875).

21. Income Taxes

Total accumulated temporary differences that arise between the Russian statutory tax base of assets and liabilities and their carrying amounts in the accompanying consolidated balance sheets, which relate primarily to revaluation of property, plant and equipment for tax purposes and payables, give rise to the following deferred tax effects:

Deferred Tax Asset /(Liability), net

	2006	2005 (restated)
Valuation of property, plant and equipment	**(12,723)**	19,578
Employee benefit obligations (refer to Note 14)	**6,077**	6,980
Valuation of inventory and related reserves	**659**	1,562
Valuation of accounts receivable	**2,542**	1,264
Payables / Accruals	**16,666**	12,158
Other	**76**	288
Total deferred tax asset, net	**13,297**	41,830
Unrecognised portion of deferred tax asset (A)	**–**	–
Balance as of 31 December	**13,297**	41,830

Deferred Tax (Liability), net

	2006	2005 (restated)
Valuation of intangible assets	**(114)**	–
Other	**(7)**	–
Balance as of 31 December	**(121)**	–

(A) The recognition of the effects of revaluation of the Company's sub-grade, which effectively implied the revision of the amount of impairment loss previously recognized with regard to the Company's property, plant and equipment, though, was considered by management to be adequate grounds for reassessment of the amount of deferred tax asset in part related to property, plant and equipment reported in the financial statements and recognition of the amounts of deferred tax assets previously unrecognized, which equated to 49,753 and 71,019 as of 31 December and 1 January 2005, respectively, before the recognition of tax effect of revaluation of property, plant and equipment of 54,332. The Company corrected the comparative financial information as of 1 January 2005 to give consideration to this re-assessment (refer to Note 2).

Tax effects of temporary differences referred to above are measured at the tax rates that are expected to apply to the periods when the asset is realized or the liability is settled, based on tax rates that have been enacted or substantively enacted by the balance sheet date. Commencing from 1 January 2002 the Government of the Russian Federation enacted the national income tax rate of 24%.

During 2005 the Company re-assessed future deductibility of certain temporary differences and derecognised the related deferred tax assets (refer below). Simultaneously, the Company increased the recognised part of the deferred tax asset related to other temporary differences, previously considered uncertain for deductibility.

21. Income Taxes (continued)

Although significant uncertainties in respect of possible changes in the tariff setting policy and for the implementation of railroad industry restructuring program (refer to Note 23) make the availability in the future of sufficient taxable profit, against which the deductible temporary difference giving rise to the deferred tax asset above can be utilized, uncertain, the balance of deferred tax asset of Rbls 13,297 (2005: 41,830) in management's opinion can be utilized through the recognition of a higher depreciation expense for tax purposes in comparison with depreciation expense for accounting purposes in future periods.

Provision for current income taxes is calculated on the basis of income, which is determined in accordance with the Russian statutory tax regulations.

Income taxes for the years ended 31 December 2006 and 2005 comprised the following:

	2006	**2005 (restated)**
Current tax charge per Russian accounting regulations	**33,479**	24,717
Deferred tax charge, net	**28,654**	22,624
	62,133	47,341
Current tax charge per Russian accounting regulations - recalculation for prior periods	**2,527**	–
(Forgiveness of) penalties related to income tax, net	**(1,228)**	(3,104)
Total income taxes	**63,432**	44,237

A reconciliation of theoretical income tax to the actual income tax expense recorded in the consolidated statements of income for the years ended 31 December 2006 and 2005 is as follows:

	2006	**2005 (restated)**
Income before taxation	**203,238**	135,077
Statutory income tax rate	**24%**	24%
Theoretical tax expense at statutory rate	**48,777**	32,419
Add (deduct) tax effect of:		
Non-deductible / (taxable) differences:		
(reversal of) provision for tax liabilities and legal claims (refer to Note 15)	**(1,635)**	(4,880)
(reversal of) provision for diminution in value of investments	**(143)**	(212)
non-deductible expenses related to social assets transferred to local municipalities	**(380)**	91
non-deductible social and other expenses, net	**14,115**	15,033
bad debt expense	**117**	933
loss on disposals of property, plant and equipment and impairment	**1,282**	1,192
	62,133	44,574
Derecognised deferred tax asset	**–**	4,000
Change in valuation allowance for other temporary differences	–	(1,233)
Total income taxes	**62,133**	47,341

22. Related Party Transactions

As defined by IAS 24 "Related Party Disclosures" the counter parties, which meet the following criteria, are treated as related parties of the reporting company:

a. enterprises that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the reporting enterprise. (This includes holding companies, subsidiaries and fellow subsidiaries);

b. associates - enterprises in which the company has significant influence and which is neither a subsidiary nor a joint venture of the investor;

c. individuals owning, directly or indirectly, an interest in the voting power of the company that gives them significant influence over the company, and anyone expected to influence, or be influenced by, that person in their dealings with the company;

d. key management personnel, that is, those persons having authority and responsibility for planning, directing and controlling the activities of the company, including directors and officers of the company and close members of the families of such individuals;

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 or major shareholders of the company and enterprises that have a member of key management in common with the company;

f. the party is a post-employment benefit plan for the benefit of employees of the entity.

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

22. Related Party Transactions (continued)

The Company entered into a variety of transactions with related parties during the years ended 31 December 2006 and 2005. The most significant of these transactions are as follows (for description of the nature of relationships between the Company and its related parties refer to definitions in a.-f. above):

2006:

Related party	Nature of relations	Type of service / product	Sales / income (A)	(Purchases) / (expenses) (A)	Accounts receivable at 31 December	(Accounts payable) at 31 December
State-controlled companies:						
1. Services rendered						
Rosneft and subsidiaries	(a)	Cargo transportation	15,168	–	–	(495)
Ministries of the Russian Federation	(a)	Cargo transportation, telecommunication services	16,771	–	1,023	–
Financing received from Regional and Federal budgets	(a)	Compensations for passenger transportation	1,579	–	–	–
Other	(a)		2,473	–	55	(53)
2. Purchases						
RAO "EES"	(a)	Electricity	–	(45,630)	152	–
FGUP "VO ZD transporta Rossii"	(a)	Security services	–	(9,626)	–	(492)
PFG "Rosvagonmash"	(b)	Rolling stock	–	(7,606)	–	(1,314)
FGUP "VNIIAS"	(a)	Research and development works	–	(2,400)	–	(1,115)
FGUP "VNIIZT"	(a)	Research and development works	–	(1,573)	–	(687)
Other	(a)		181	(1,206)	1,938	(77)
3. Financial services						
Gazprombank	(a)	Loans payable	–	–	–	(100)
TransCreditBank	(a)	Loans payable	–	–	–	(350)
ZAO "TFK"	(a)	Loans payable	–	–	–	(586)
OOO FinancePromMarket	(a)	Loans payable	–	–	–	(623)
Other companies:						
OAO "ZHASO"	(e)	Insurance expense	–	(4,557)	–	(44)
		Premiums received by medical organizations	4,534	–	–	–
Blagosostoyanie	(f)	Pension contributions	–	(13,859)	–	(325)
		Contribution to finance activities		(698)		
Pochet	(f)	Not–for–profit fund	–	(2,307)	–	–
Other	(a), (b)		–	(5,908)	98	(678)

22. Related Party Transactions (continued)

(A) Amounts are reported before elimination of VAT.

During 2006 and 2005 the Company maintained several bank accounts in state-controlled credit institutions. The amount of cash and deposits held in these institutions as of 31 December 2006 equated to Rbls 15,851 (2005: 9,322), which are comprised the following:

	2006	2005
Cash	**9,573**	9,322
Long-term deposits	**5,252**	–
Short-term deposits	**1,026**	–
Total	**15,851**	9,322

Further, during 2006 the Company received tariff compensation of Rbls 10,496 (2005: 7,068) for transportation of certain categories of passengers from Health Care and Social Development Agency of Russia.

In addition, the Company recognized bad debt expense of Rbls 5,922 relating to accounts receivable balance outstanding as of 31 December 2006 with regard to the tariff compensation for transportation of certain categories of passengers (2005: 592).

2005:

Related party	Nature of relations	Type of service / product	Sales / income (A)	(Purchases) / (expenses) (A)	Accounts receivable at 31 December	(Accounts payable) at 31 December
State-controlled companies:						
1. Services rendered						
Rosneft and subsidiaries	(a)	Cargo transportation	13,636	–	–	(567)
Ministries of the Russian Federation	(a)	Cargo transportation, telecommunication services	15,106	–	364	–
Financing received from Regional and Federal budgets	(a)	Compensations for passenger transportation	1,628	–	237	–
Other	(a)		2,173	–	369	–
2. Purchases						
RAO "EES"	(a)	Electricity	–	(50,520)	76	–
FGUP "VO ZD transporta Rossii"	(a)	Security services	–	(8,117)	–	(607)
FGUP "VNIIAS"	(a)	Research and development works	–	(2,128)	–	(548)
FGUP "VNIIZT"	(a)	Research and development works	–	(1,846)	–	(692)
Other	(a)		222	(2,240)	1,000	(1,053)
3. Financial services						
Gazprombank	(a)	Loans payable	–	–	–	(8,765)
Sberbank	(a)	Loans payable	–	–	–	(3,503)

22. Related Party Transactions (continued)

Related party	Nature of relations	Type of service / product	Sales / income (A)	(Purchases) / (expenses) (A)	Accounts receivable at 31 December	(Accounts payable) at 31 December
Other companies:						
OAO "ZHASO"	(e)	Insurance expense	–	(4,927)	–	(5)
		Premiums received by medical organizations	4,176	–	–	–
Blagosostoyanie	(f)	Pension contributions	–	(9,533)	–	(369)
		Contribution to finance activities		(362)		
Pochet	(f)	Not–for–profit fund	–	(2,448)	–	–
Other	(a), (b)		–	(3,460)	–	(322)

(A) Amounts are reported before eliminating of VAT.

Key management personnel comprise members of the Management Board and the Board of Directors of the Company. Total remuneration to the members of Management Board included in "Wages, salaries and related contribution" in the statement of income amounted to Rbls 374 for the year ended 31 December 2006 (2005: 288) and consists of short-term benefits.

Management believes that transactions with other related party entities are insignificant.

23. Commitments and Contingencies

Environment

The operations and earnings of the Company are affected by political, legislative, fiscal and regulatory developments. The nature and frequency of these developments and events associated with these risks, which generally are not covered by insurance, as well as their effect on future operations and earnings are not predictable.

In particular, the implementation of the Program of railway transportation restructuring during the period 2001-2010 developed by the Company, the Ministry of Economic Development and Trade of the Russian Federation, Antimonopoly Ministry, Ministry of State Property of the Russian Federation and certain other ministries and approved by the Government of the Russian Federation, is likely to have a significant effect on the operations of the Company.

As referred to in Note 1, under the Program a state-owned open joint stock company RZD was established. It is planned that the Company's activities will be focused solely on provision of transportation services and maintenance of railroads infrastructure, whilst auxiliary business activities and the related facilities will be transferred to independent newly established entities. Further, a part of the Company's employees will also be transferred to such entities. During 2006 the Company continued the process of incorporation of such entities and established several entities engaged in provision of forwarding services as related to container transportation, refrigerator transportation and construction services (refer to Note 1). However, in respect to other activities their definition, identification of their related assets and corresponding liabilities and further the definition of ownership and business relations between the Company and such new entities have not been finalized as of 31 December 2006 (refer to Note 25 for further comments).

23. Commitments and Contingencies (continued)

Tariff Regulation Policy

Potential reforms in tariff-setting policy, including abandonment of cross subsidy practices, may have a significant effect on the Company. The Company is continuously discussing the tariff setting policy, including both unification of such tariffs between domestic and foreign transportation, and increases in the tariffs with the Government of the Russian Federation. However, such attempts to increase transportation tariffs are opposed by the Company's customers. At present, the Government of the Russian Federation plans to limit the growth of the Company's tariffs to inflation growth. It is currently uncertain whether any further changes will be introduced in the tariff setting policy. The accompanying consolidated financial statements do not include any adjustments that might result from these uncertain effects. Such adjustments, if any, will be reported in the Company's consolidated financial statements in the period when they become known and estimable.

Taxation

Russia currently has a number of taxes imposed by both federal and regional governmental authorities. Applicable taxes include value added tax, corporate income tax (profit tax), property tax and payroll (social) taxes, together with others.

In recent years, the Russian government has initiated revisions of the Russian tax system. Effective 1 January 1999, the first part of the Tax Code was enacted. Effective 1 January 2001, the second part of the Tax Code (with the exception for profit tax and property tax rules) was enacted. Effective 1 January 2002 and 1 January 2004 new principles for income tax and property tax calculation, respectively, were further enacted. The new tax system is generally intended to reduce the number of taxes and, thus, the overall tax burden on businesses, and to simplify the tax laws.

However, Russian tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Company may be challenged by the relevant regional and federal authorities. Recent events within the Russian Federation suggest that the tax authorities are taking a more assertive position in its interpretation of the legislation and assessments and as a result, it is possible that transactions and activities that have not been challenged in the past may be challenged. As such, significant additional taxes, penalties and interest may be assessed. In addition, the complexities of the Company's organizational and business flows structure negatively affect the Company's ability to ensure proper application of certain provisions of tax laws, thus creating additional risks, and, as a consequence, tax-related contingent liabilities.

Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

Management believes that it has adequately provided for tax liabilities in the accompanying consolidated balance sheet as of 31 December 2006 (refer also to Note 15). However, the general risk remains that relevant authorities could take different positions with regard to interpretative issues and the effect could be significant.

23. Commitments and Contingencies (continued)

Claims and Potential Claims against the Company

The Company is subject to a number of proceedings arising out of the normal circumstances of its business. These proceedings revolve primarily around application of transportation tariffs. As of 31 December 2006 a provision regarding such proceedings of Rbls 1,255 (2005: Rbls 3,849) was recognised by the Company. Significant decrease in the provision above relates to the resolution in the Company's favor of disputes with its customers.

Social Assets Maintenance

As discussed in Note 1, as part of transfer of social assets to the local municipalities, the Company committed to continue financing maintenance costs regarding such social assets during 2007. Management estimated the total amount of such expenses equate approximately to Rbls 240 (2005: 730).

Insurance

The Russian insurance industry is in a developing stage and many forms of insurance protection common in other parts of the world are not yet available. Although during 2006 the Company extended insurance coverage regarding certain categories of its property (primarily rolling stock), the Company did not maintain insurance coverage on significant other part of its property, plant and equipment, business interruption or third party liability in respect of property or environmental damage arising from accidents to the Company's property or relating to the Company's operations. Until the Company obtains adequate insurance coverage, there is a risk that the loss or destruction of certain assets could have a material adverse effect on the Company's operations and financial position.

Purchase Commitments

1. The Company has a long-term contract with Siemens AG regarding the purchase of high-speed trains for Moscow - St. Petersburg and Moscow – Nizhny Novgorod lines for the aggregate amount of EUR 276 million (Rbls 9,576 at the exchange rate as of 31 December 2006).

   Subsequent to 31 December 2006 the Company's Board of Directors approved a long-term loan agreement in the aggregate amount not exceeding EUR 300 million (Rbls 10,409 at the exchange rate as of 31 December 2006) to finance the contract referred to above.

2. The Company has a long-term contract signed with Unified Metallurgical Company for purchase of rail wheels. The original value of the contract equated to approximately USD 1,250 million (Rbls 34,687 at the exchange rate as of 31 December 2004). Under the contract the approximate amount of deliveries expected after 31 December 2006 amounts to Rbls 35,500.

24. Financial Instruments and Risk Management Objectives and Policies

The Company's principal financial instruments comprise bank loans, finance leases, cash and bank deposits. The main purpose of these instruments is to raise finance for the Company's operations. The Company has other financial assets and liabilities such as trade receivables and trade payables, which arise directly from its operations.

Credit Risk

Credit risk is the risk that a counter party will fail to discharge an obligation and cause the Company to incur a financial loss.

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

Cash is placed in financial institutions, which are considered at time of deposit to have minimal risk of default.

Foreign Exchange Risk

A part of Company's receivables and payables balances, related primarily to settlements with customers is denominated in currencies other than Ruble. This exposes the Company to foreign exchange risk.

Further, the loan obtained by the Company from a consortium of banks (refer to Note 12) is denominated in US Dollars. For the period from 31 December 2005 to 31 December 2006 the exchange rate of the Russian Ruble to the US Dollar increased by approximately 8,5%.

The Company does not have formal arrangements to mitigate foreign exchange risks of the Company's operations.

Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates may negatively impact the Company's financial results. The Company is exposed to interest rate risk through market value fluctuations of interest-bearing long-term borrowings. The majority of interest rates on the borrowings are fixed, these are disclosed in Note 12.

Except for short-term interest-bearing deposits (refer to Note 7) and long-term interest-bearing deposits (refer to Note 5), the Company has no significant interest-bearing assets.

24. Financial Instruments and Risk Management Objectives and Policies (continued)

Fair Value

Fair value of a financial instrument is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction (except for forced sale or liquidation). Market prices are considered to be the best evidence of fair value.

Management believes that the carrying values of financial assets and liabilities approximate their fair values.

In case management becomes aware that carrying value materially exceeds the fair value of certain financial assets, specific valuation allowances will be recorded to provide for the specific assets.

25. Subsequent Events

Increase in Share Capital

Subsequent to 31 December 2006, the Russian government resolved to increase the share capital of RZD by contributing a number of investments held by the government, including 75% equity interest in TransCreditBank that was previously expropriated.

Financial Guarantees

Subsequent to 31 December 2006, the Company issued a guarantee with regard to the liabilities of "Vysokoskorostnye Magistrali", an open joint stock company, towards the Ministry of Finance of Russia in the amount of approximately US$33.7 million (Rbls 887 million at the exchange rate as of 31 December 2006).

Subsidiaries and Other Investments

Establishment of cargo transportation companies

In 2007 the Company and the governmental bodies involved in implementation of the Program of railway transportation restructuring during 2001-2010 reached an agreement on the concept and general principles of creation of Cargo Transportation Company ("CTC-1"), a new 100% subsidiary. Under the proposed plan, it is expected that the Company will contribute up to 50% of its cargo cars to the share capital of CTC-1. The new subsidiary is expected to be created by 2008. It is further planned that in 2009 the second Cargo Transportation Company ("CTC-2") will be established. This entity will receive the remaining balance of RZD's cargo cars.

Joint ventures, subsidiaries and associates

Subsequent to 31 December 2006, the Company established a number of joint ventures and subsidiaries. The most significant of such entities is RailTransAvto (open joint-stock company), - a 51% subsidiary established by the Company and TransGroup AS for the purpose of arranging specialized transportation of cars.

25. Subsequent Events (continued)

Subsidiaries and Other Investments (continued)

Joint ventures, subsidiaries and associates (continued)

The Company's Board of Directors further approved issuance of a loan to "Skorostnye magistrali" in the amount of Rbls 591.

In 2007 Russkaya Troika, a 50% joint venture of the Company involved in container transportation, resolved to increase its share capital through issuance of additional shares. It is planned that the shares will be acquired by the pension fund Blagosostoyanie, a related party (refer to Note 14). As a result, the Company's share in this joint venture will decrease to approximately 25%. It is further expected that the Company will receive an option to re-purchase the shares acquired by Blagosostoyanie.

Elgaugol

In 2007, the Company together with the Ministry of Economic Development and Trade of the Russian Federation, the Federal Agency of State Property of the Russian Federation and the regional government of Sakha Yakutia agreed on the terms of the public auction regarding sale of the Company's 29.5% ownership interest in Elgaugol and the related construction in process project. The investment in Elgaugol as of 31 December 2006 equated to Rbls 44 before 100% provision for diminution in value. The value of construction in progress project referred to above equated to Rbls 9,554 as of 31 December 2006. A 100% provision for impairment was recognised with regard to this project as of the above date (refer to Note 3).

It is currently expected that the auction starting price will equate to Rbls 2.9 billion for ownership interests in Elgaugol and Rbls 11 billion for construction in progress project referred to above.

Considering that the Company's assets above will be auctioned as one set together with certain other assets owned by the regional government of Sakha Yakutia, and further considering that under the terms of the auction the potential buyer is obligated to invest significant resources in the completion by October 2010 of the construction in process project above, management is of the opinion that uncertainties continue to exist as to whether this auction will allow the Company to realize its investments related to Elgaugol project. Accordingly, management resolved to maintain the provision for impairment of the assets referred to above.

Other

Subsequent to the year end the Company's Board of Directors approved the program of selling non-controlling interests in a number of RZD's subsidiaries.

25. Subsequent Events (continued)

Dividends

In 2007 the Company declared dividends related to 2006 of Rbls 1,051.

Government Grants

In 2007 the Russian government approved the provision in 2007 of a grant in the amount of Rbls 10.5 billion to compensate the expected Company's losses on passenger transportation.

ERNST & YOUNG

Ernst & Young LLC
Sadovnicheskaya Nab., 77, bld. 1
Moscow, 115035, Russia
Tel.: 7 (495) 705-9700
7 (495) 755-9700
Fax: 7 (495) 755-9701
www.ey.com/russia

ООО «Эрнст энд Янг»
Россия, 115035, Москва
Садовническая наб., 77, стр. 1
Тел.: 7 (495) 705-9700
7 (495) 755-9700
Факс: 7 (495) 755-9701
ОКПО: 59002827

Independent Auditors' Report

To the Shareholders of
Open Joint Stock Company "Russian Railroads"

We have audited the accompanying consolidated financial statements of OAO "Russian Railroads" and its subsidiaries (hereinafter referred to as "the Company"), which comprise the consolidated balance sheet as of 31 December 2006, and the consolidated statement of income, consolidated statement of cash flows and consolidated statement of changes in equity for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of 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.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance 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 financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Basis for Qualified Opinion

(i) As discussed in Note 2 to the consolidated financial statements, in accordance with the Company's accounting policy, subsequent to initial recognition, property, plant and

equipment are carried at revalued amounts being their fair values at the date of the revaluation less any subsequent accumulated depreciation and impairment loss. In accordance with the requirements of International Accounting Standard 16 "Property, Plant and Equipment" ("IAS 16"), as amended, revaluations should be made with sufficient regularity such that the carrying amount of property, plant and equipment does not differ materially from that which would be determined using fair value at the balance sheet date. The Company completed revaluation of one category of property, plant and equipment as of 1 January 2004 and reported the effects of such revaluation by adjusting corresponding information in the consolidated financial statements. The last revaluation of the Company's other categories of property, plant and equipment was performed as of 31 December 1998. Therefore, we were unable to determine whether the carrying value of such other categories of property, plant and equipment of 1,068,481 and 898,713 millions of rubles as of 31 December 2006 and 2005, respectively, complies with the requirement referred to above. Similarly, we could not determine whether the impairment reserves provided by the Company, are adequate to reflect the value of the Company's total property, plant and equipment at its recoverable value. The effects of this departure from International Financial Reporting Standards on the consolidated financial statements, including but not limited to the effect on depreciation expense and the related deferred income tax, have not been determined.

(ii) As of 1 January 2005, the Company commenced the application of a more comprehensive approach to components accounting for property, plant and equipment by re-defining certain significant components and revising its accounting estimates regarding their useful lives. These changes were accounted for by the Company as change in estimates. However, the Company has not consistently applied these new policies for component accounting, including capitalization and determination of useful lives, to certain property, plant and equipment in the year ended 31 December 2006. The effects of this departure from International Financial Reporting Standards on the consolidated financial statements, including, but not limited to, the effect on carrying values of property, plant and equipment, deferred tax assets as of 31 December 2006 and 2005, depreciation expense, deferred income tax charge, and disposal of items of property, plant and equipment for the years then ended, have not been determined.

Qualified Opinion

In our opinion, except for the effects on the consolidated financial statements of the matters described in the Basis for Qualified Opinion paragraphs (i) and (ii), the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of 31 December 2006, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Emphasis of Matter

We draw attention to Note 23 to the consolidated financial statements. OAO "Russian Railroads" together with the Ministry of Economic Development and Trade, the Federal Agency of State Property of the Russian Federation and certain other ministries, continued implementation of the Program of railway transportation restructuring.

Ernst & Young LLC

31 August 2007