



**Bank “National Factoring Company”
(Closed Joint Stock Company)
Financial Statements**

Year ended 31 December 2007

Together with Independent Auditors’ Report

Ernst & Young

CONTENTS

INDEPENDENT AUDITORS' REPORT

Balance sheet	1
Income statement	2
Statement of changes in equity	3
Cash flow statement	4

NOTES TO FINANCIAL STATEMENTS

1. Principal activities	5
2. Basis of preparation	5
3. Summary of accounting policies	6
4. Significant accounting estimates	12
5. Cash and cash equivalents	13
6. Trading securities	13
7. Amounts due from credit institutions	13
8. Derivative financial instruments	14
9. Factoring advances and loans	14
10. Taxation	16
11. Other assets and liabilities	16
12. Amounts due to credit institutions	17
13. Debt securities issued	17
14. Equity	17
15. Commitments and contingencies	18
16. Interest income from factoring operations	19
17. Personnel and other operating expenses	19
18. Risk management	19
19. Fair values of financial instruments	28
20. Related party disclosures	29
21. Capital	30
22. Events after the balance sheet date	30

INDEPENDENT AUDITORS' REPORT

To the Shareholders and Board of Directors of Bank National Factoring Company (Closed Joint Stock Company) –

We have audited the accompanying financial statements of Bank National Factoring Company (Closed Joint Stock Company), which comprise the balance sheet as at 31 December 2007, the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the 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.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Bank National Factoring Company (Closed Joint Stock Company) as at 31 December 2007, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

15 April 2008

Ernst & Young Vneshaudit

BALANCE SHEET**As of 31 December 2007***(Thousands of Russian Rubles)*

	<i>Notes</i>	<i>2007</i>	<i>2006</i>
Assets			
Cash and cash equivalents	5	2,159,755	654,909
Trading securities	6	20,638	20,711
Amounts due from credit institutions	7	886,031	230,650
Factoring advances and loans	9	7,051,356	5,987,526
Deferred income tax assets	10	994	6,659
Other assets	11	183,335	47,387
Total assets		10,302,109	6,947,842
Liabilities			
Amounts due to credit institutions	12	6,152,923	3,644,468
Derivative financial liabilities	8	–	23,176
Debt securities issued	13	1,547,524	1,008,974
Settlements with clients on factoring		114,918	107,987
Current income tax liabilities	10	18,270	8,317
Other liabilities	11	41,265	28,859
Total liabilities		7,874,900	4,821,781
Equity			
Share capital	14	1,456,000	1,456,000
Retained earnings		971,209	670,061
Total equity		2,427,209	2,126,061
Total equity and liabilities		10,302,109	6,947,842

Signed and authorised for release on behalf of the Management Board of the Bank

Mikhail I. Treyvish

Chairman of Management Board

Dmitry V. Baryshnikov

Chief Accountant

15 April 2008

The accompanying notes on pages 5 to 30 are an integral part of these financial statements.

INCOME STATEMENT**For the year ended 31 December 2007***(Thousands of Russian Rubles)*

	<i>Notes</i>	<i>2007</i>	<i>2006</i>
Interest income			
Factoring	16	1,356,345	985,123
Due from credit institutions		62,896	27,341
Loans		22,027	13,643
Trading securities		1,282	1,283
		1,442,550	1,027,390
Interest expense			
Due to credit institutions		381,272	160,057
Debt securities issued		93,663	66,129
Deposits		35	534
		474,970	226,720
Net interest income		967,580	800,670
Allowance (reversal of allowance) for loan impairment	9	(74,801)	(72,817)
Net interest income after allowance for loan impairment		892,779	727,853
Net fee and commission income (expense)		(3,641)	(2,033)
Net gains/(losses) from trading securities		(76)	19
Net gains/(losses) from foreign currencies:			
- dealing		(32,104)	(25,121)
- translation differences		28,875	28,734
Other income		674	596
Non-interest income (expense)		(6,272)	2,195
Personnel expenses	17	286,454	196,092
Administrative and operating expenses	17	179,272	128,726
Depreciation		3,373	2,647
Non-interest expense		469,099	327,465
Profit before income tax expense		417,408	402,583
Income tax expense	10	116,260	100,730
Profit for the year		301,148	301,853

The accompanying notes on pages 5 to 30 are an integral part of these financial statements.

STATEMENT OF CHANGES IN EQUITY**For the year ended 31 December 2007***(Thousands of Russian Rubles)*

	<i>Notes</i>	<i>Share capital</i>	<i>Retained earnings</i>	<i>Statutory fund</i>	<i>Accumulated partners' funds</i>	<i>Total</i>
December 31, 2005		–	–	1,456,000	368,208	1,824,208
Issuance of shares in connection with legal reorganization	14	1,456,000	368,208	(1,456,000)	(368,208)	–
Net income		–	301,853	–	–	301,853
December 31, 2006	14	1,456,000	670,061	–	–	2,126,061
Net income		–	301,148	–	–	301,148
December 31, 2007	14	1,456,000	971,209	–	–	2,427,209

The accompanying notes on pages 5 to 30 are an integral part of these financial statements.

CASH FLOW STATEMENT**For the year ended 31 December 2007***(Thousands of Russian Rubles)*

	<i>Notes</i>	<i>2007</i>	<i>2006</i>
Cash flows from operating activities			
Interest, fees and commissions received		1,422,146	993,080
Interest, fees and commissions paid		(464,186)	(236,924)
Realised gains less losses from dealing in foreign currencies		(57,010)	(1,945)
Other income received		674	596
Personnel expenses		(260,982)	(200,183)
Other operating expenses paid		(179,258)	(128,726)
Cash flows from operating activities before changes in operating assets and liabilities		461,384	425,898
<i>Net (increase)/decrease in operating assets</i>			
Amounts due from credit institutions		(689,959)	56,709
Factoring advances and loans		(1,152,234)	(1,652,196)
Other assets		(132,088)	(8,685)
<i>Net increase / (decrease) in operating liabilities</i>			
Amounts due to credit institutions		2,574,817	67,509
Settlements with clients on factoring		6,934	30,441
Time deposits of clients		500	(30,944)
Other liabilities		11,529	(1,981)
Net cash flows from operating activities before income tax		1,080,883	(1,113,249)
Income tax paid		(100,642)	(98,687)
Net cash from/(used in) operating activities		980,241	(1,211,936)
Cash flows from investing activities			
Purchase of property and equipment		(6,420)	(8,471)
Proceeds on disposals of property and equipment		3,602	-
Net cash from/(used in) investing activities		(2,818)	(8,471)
Cash flows from financing activities			
Proceeds from bonds issued		-	1,000,000
Redemption of bonds issued		(266,738)	-
Proceeds from credit linked notes issued		800,000	-
Net cash from/(used in) financing activities		533,262	1,000,000
Effect of exchange rates changes on cash and cash equivalents		(5,839)	73
Net increase/(decrease) in cash and cash equivalents		1,504,846	(220,334)
Cash and cash equivalents, beginning		654,909	875,243
Cash and cash equivalents, ending	5	2,159,755	654,909

The accompanying notes on pages 5 to 30 are an integral part of these financial statements.

(Thousands of Russian Rubles)

1. Principal activities

Bank “National Factoring Company” (Closed Joint Stock Company) (the “Bank”) was formed in 2003 as a limited liability company under the laws of the Russian Federation. The Bank operates under a banking licence issued by the Central Bank of Russia (“CBR”) in March 2004. In November 2005 the CBR reissued the license. This license gives the Bank a right to perform operations with legal entities (including credit institutions).

The Bank's core operations are factoring services, including financing transactions against cash cession and other transactions with trade receivables of business entities in the Russian Federation and abroad. The Bank acts as a factor for Russian and foreign legal entities and as an import factor for foreign factoring companies. The Bank is a member of Factors Chain International (FCI), International Factors Group (IFG) – special professional associations of the global factoring market. The Bank is one of the leaders in the Russian factoring market.

As of December 21, 2006, the Bank registered with the CBR the change in its legal form from limited liability company to closed joint stock company (CJSC). That change resulted in recognizing accumulated earnings and share capital as equity in these financial statements instead of liability (partners' funds) as in previous years.

As of December 31 2007, the following shareholders owned the outstanding shares:

Shareholder	<i>2007</i> %	<i>2006</i> %
Salerna LLC	50.0	50.0
Centerryboproduct LLC	50.0	50.0
Total	100.0	100.0

The Bank is ultimately controlled by Mr. Nikolai Tsvetkov.

The Bank's main office is located in Moscow and it has 21 operating outlets in the Russian Federation. The Bank's registered legal address is 14 Kozhevnichestkaya Street, Moscow, Russia, 115114. The Bank had an average of 313 employees during 2007 (2006 – 246) and 371 employees as of December 31, 2007 (2006 – 286).

2. Basis of preparation

General

These financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”).

The Bank is required to maintain its records and prepare its financial statements for regulatory purposes in Russian Rubles in accordance with Russian accounting and banking legislation and related instructions (“RAL”). These financial statements are based on the Bank's RAL books and records, as adjusted and reclassified in order to comply with IFRS. The reconciliation between RAL and IFRS is presented later in this note.

The financial statements have been prepared under the historical cost convention except as disclosed in the accounting policies below. For example, trading and available-for-sale securities, derivative financial instruments have been measured at fair value.

These financial statements are presented in thousands of Russian Rubles (“RUB”), except per share amounts and unless otherwise indicated.

(Thousands of Russian Rubles)

2. Basis of preparation (continued)

Reconciliation of RAL and IFRS equity and profit for the year

Equity and profit for the year are reconciled between RAL and IFRS as follows:

	2007		2006	
	<i>Equity</i>	<i>Profit for the year</i>	<i>Equity</i>	<i>Profit for the year</i>
Russian Accounting Legislation	2,162,011	272,174	2,042,537	304,917
Capitalisation of distribution from funds	152,700	–	–	–
Effect of accrued interest	97,674	5,979	91,695	42,482
Impairment of financial assets	50,713	29,108	21,605	(40,566)
Accrual of additional compensation benefit	(38,481)	(25,472)	(13,009)	4,091
Derivatives	1,730	24,906	(23,176)	(23,176)
Deferred tax	994	(5,665)	6,659	14,112
Other	(132)	118	(250)	(7)
International Financial Reporting Standards	2,427,209	301,148	2,126,061	301,853

3. Summary of accounting policies

Financial assets

Initial recognition

Financial assets in the scope of IAS 39 are classified as either financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, or available-for-sale financial assets, as appropriate. When financial assets are recognised initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs. The Bank determines the classification of its financial assets upon initial recognition.

Date of recognition

All regular way purchases and sales of financial assets are recognised on the trade date i.e. the date that the Bank commits to purchase the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

Day 1' profit

Where the transaction price in a non-active market is different to the fair value from other observable current market transactions in the same instrument or based on a valuation technique whose variables include only data from observable markets, the Bank immediately recognises the difference between the transaction price and fair value (a 'Day 1' profit) in the income statement. In cases where use is made of data which is not observable, the difference between the transaction price and model value is only recognised in the income statement when the inputs become observable, or when the instrument is derecognised.

Financial assets at fair value through profit or loss

Financial assets classified as held for trading are included in the category 'financial assets at fair value through profit or loss'. Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives are also classified as held for trading unless they are designated and effective hedging instruments. Gains or losses on financial assets held for trading are recognised in the income statement.

Held-to-maturity investments

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held-to-maturity when the Bank has the positive intention and ability to hold them to maturity. Investments intended to be held for an undefined period are not included in this classification. Held-to-maturity investments are subsequently measured at amortised cost. Gains and losses are recognised in the income statement when the investments are impaired, as well as through the amortisation process.

(Thousands of Russian Rubles)

3. Summary of accounting policies (continued)

Financial assets (continued)

Factoring advances, loans and receivables

Factoring advances, 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 the income statement when the loans, factoring advances and receivables are derecognised or impaired, as well as through the amortisation process.

Determination of fair value

The fair value for financial instruments traded in active market at the balance sheet date is based on their quoted market price or dealer price quotations (bid price for long positions and ask price for short positions), without any deduction for transaction costs.

For all other financial instruments not listed in an active market, the fair value is determined by using appropriate valuation techniques. Valuation techniques include net present value techniques, comparison to similar instruments for which market observable prices exist, options pricing models and other relevant valuation models.

Offsetting

Financial assets and liabilities are offset and the net amount is reported in the balance sheet when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, amounts due from the CBR, excluding obligatory reserves, and amounts due from credit institutions that mature within ninety days of the date of origination and are free from contractual encumbrances.

Derivative financial instruments

In the normal course of business, the Bank enters into various derivative financial instruments including futures, forwards, swaps and options in the foreign exchange and capital markets. Such financial instruments are held for trading and are recorded at fair value. The fair values are estimated based on quoted market prices or pricing models that take into account the current market and contractual prices of the underlying instruments and other factors. Derivatives are carried as assets when their fair value is positive and as liabilities when it is negative. Gains and losses resulting from these instruments are included in the income statement as gains less losses from trading securities or gains less losses from foreign currencies dealing, depending on the nature of the instrument.

Derivatives embedded in other financial instruments are treated as separate derivatives and recorded at fair value if their economic characteristics and risks are not closely related to those of the host contract, and the host contract is not itself held for trading or designated at fair value through profit or loss. The embedded derivatives separated from the host are carried at fair value on the trading portfolio with changes in fair value recognised in the income statement.

Promissory notes

Promissory notes purchased are included in trading securities, or in amounts due from credit institutions or in loans to customers, depending on their substance and are accounted for in accordance with the accounting policies for these categories of assets.

Borrowings

Issued financial instruments or their components are classified as liabilities, where the substance of the contractual arrangement results in the Bank having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity instruments. Such instruments include amounts due to the Central bank and Government, amounts due to credit institutions, amounts due to customers and debt securities issued. After initial recognition, borrowings are subsequently measured at amortised cost using the effective interest method. Gains and losses are recognised in the income statement when the borrowings are derecognised as well as through the amortisation process.

(Thousands of Russian Rubles)

3. Summary of accounting policies (continued)

Borrowings (continued)

If the Bank purchases its own debt, it is removed from the balance sheet and the difference between the carrying amount of the liability and the consideration paid is recognised in the income statement.

Leases

Operating – Bank as lessee

Leases of assets under which the risks and rewards of ownership are effectively retained by the lessor are classified as operating leases. Lease payments under an operating lease are recognised as expenses on a straight-line basis over the lease term and included into other operating expenses.

Impairment of financial assets

The Bank assesses at each balance sheet date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

Amounts due from credit institutions, factoring advances and loans to customers

For amounts due from credit institutions, factoring advances and loans to customers carried at amortised cost, the Bank first assesses individually whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risks characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment.

If there is an objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the assets' carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement. Interest income continues to be accrued on the reduced carrying amount based on the original effective interest rate of the asset. Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Bank. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account. If a future write-off is later recovered, the recovery is credited to the income statement.

The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of the Bank's internal credit grading system that considers credit risk characteristics such as asset type, industry, geographical location, collateral type, past-due status and other relevant factors.

(Thousands of Russian Rubles)

3. Summary of accounting policies (continued)

Impairment of financial assets (continued)

Future cash flows on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the years on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in future cash flows reflect, and are directionally consistent with, changes in related observable data from year to year (such as changes in unemployment rates, property prices, commodity prices, payment status, or other factors that are indicative of incurred losses in the group or their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Derecognition of financial assets and liabilities

Financial assets

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised where:

- the rights to receive cash flows from the asset have expired;
- the Bank has transferred its rights to receive cash flows from the asset, or retained the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a 'pass-through' arrangement; and
- the Bank either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

Where the Bank has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Bank continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Bank could be required to repay.

Where continuing involvement takes the form of a written and/or purchased option (including a cash-settled option or similar provision) on the transferred asset, the extent of the Bank continuing involvement is the amount of the transferred asset that the Bank may repurchase, except that in the case of a written put option (including a cash-settled option or similar provision) on an asset measured at fair value, the extent of the Bank continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

Financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in the income statement.

Financial guarantees

In the ordinary course of business, the Bank gives financial guarantees. Financial guarantees are initially recognised in the financial statements at fair value, in 'Other liabilities', being the premium received. Subsequent to initial recognition, the Bank's liability under each guarantee is measured at the higher of the amortised premium and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

(Thousands of Russian Rubles)

3. Summary of accounting policies (continued)

Taxation

The current income tax expense is calculated in accordance with the regulations of the Russian Federation.

Deferred tax assets and liabilities are calculated in respect of temporary differences using the liability method. 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.

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

Deferred income tax is provided on temporary differences arising on investments in subsidiaries, associates and joint ventures, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

Russia also has various operating taxes, that are assessed on the Bank activities. These taxes are included as a component of other operating expenses.

Property and equipment

Property and equipment are carried at cost, excluding the costs of day-to-day servicing, less accumulated depreciation and any accumulated impairment. Such cost includes the cost of replacing part of equipment when that cost is incurred if the recognition criteria are met.

The carrying values of property and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

Depreciation of an asset begins when it is available for use. Depreciation is calculated on a straight-line basis over the following estimated useful lives:

	<u>Years</u>
Furniture and fixtures	2-5
Computers and office equipment	5
Motor vehicles	4

The asset's residual values, useful lives and methods are reviewed, and adjusted as appropriate, at each financial year-end.

Costs related to repairs and renewals are charged when incurred and included in other operating expenses, unless they qualify for capitalization.

Provisions

Provisions are recognised when the Bank has a present legal or constructive obligation as a result of past events, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate of the amount of obligation can be made.

Retirement and other employee benefit obligations

The Bank does not have any pension arrangements separate from the State pension system of the Russian Federation, which requires current contributions by the employer calculated as a percentage of current gross salary payments; such expense is charged in the period the related salaries are earned. In addition, the Bank has no significant post-retirement benefits.

The part of management stimulation program represents advances granted to top management. The transaction effectively represents long-term employee benefits with advance payments. The Bank amortizes these advances under the straight-line method over the vesting period.

(Thousands of Russian Rubles)

3. Summary of accounting policies (continued)

Share capital

Share capital

Ordinary shares and non-redeemable preference shares with discretionary dividends are both classified as equity. External costs directly attributable to the issue of new shares, other than on a business combination, are shown as a deduction from the proceeds in equity. Any excess of the fair value of consideration received over the par value of shares issued is recognised as additional paid-in capital.

Dividends

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

Contingencies

Contingent liabilities are not recognised in the balance sheet but are disclosed unless the possibility of any outflow in settlement is remote. A contingent asset is not recognised in the balance sheet but disclosed when an inflow of economic benefits is probable.

Recognition of income and expenses

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Bank and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised:

Interest and similar income and expense

For all financial instruments measured at amortised cost and interest bearing securities classified as trading or available-for-sale, interest income or expense is recorded at the effective interest rate, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument (for example, prepayment options) and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective interest rate, but not future credit losses. The carrying amount of the financial asset or financial liability is adjusted if the Bank revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest income or expense.

Once the recorded value of a financial asset or a group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognised using the original effective interest rate applied to the new carrying amount.

Dividend income

Revenue is recognised when the Bank's right to receive the payment is established.

Foreign currency translation

The financial statements are presented in Russian Rubles, which is the Bank's functional and presentation currency. Transactions in foreign currencies are initially recorded in the functional currency, converted at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date. Gains and losses resulting from the translation of foreign currency transactions are recognised in the income statement as gains less losses from foreign currencies - translation differences. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

(Thousands of Russian Rubles)

3. Summary of accounting policies (continued)

Foreign currency translation (continued)

Differences between the contractual exchange rate of a transaction in a foreign currency and the Central Bank exchange rate on the date of the transaction are included in gains less losses from dealing in foreign currencies. The official CBR exchange rates at 31 December 2007 and 31 December 2006, were 24.55 Rubles and 26.33 Rubles to 1 USD, respectively.

Changes in accounting policies

During the year, the Bank has adopted the following new and amended IFRS during the year. Adoption of these standards did not have any effect on the financial performance or position of the Bank. The principal effects of these changes are as follows:

IFRS 7 "Financial Instruments: Disclosures"

This standard requires disclosures that enable users of the financial statements to evaluate the significance of the Bank's financial instruments and the nature and extent of risks arising from those financial instruments. The new disclosures are included throughout the financial statements.

Amendment to IAS 1 "Presentation of Financial Statements"

This amendment requires the Bank to make new disclosures to enable users of the financial statements to evaluate the Bank's objectives, policies and processes for managing capital. These new disclosures are shown in Note 21.

Future changes in accounting policies

Standards and interpretations issued but not yet effective

IAS 23 "Borrowing Costs"

A revised IAS 23 Borrowing costs was issued in March 2007, and becomes effective for financial years beginning on or after 1 January 2009. The standard has been revised to require capitalisation of borrowing costs when such costs relate to a qualifying asset. A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. In accordance with the transitional requirements in the Standard, the Bank will adopt this as a prospective change. Accordingly, borrowing costs will be capitalised on qualifying assets with a commencement date after 1 January 2009. No changes will be made for borrowing costs incurred to this date that have been expensed.

IFRIC 12 "Service Concession Arrangements"

IFRIC Interpretation 12 was issued in November 2006 and becomes effective for annual periods beginning on or after 1 January 2008. This Interpretation applies to service concession operators and explains how to account for the obligations undertaken and rights received in service concession arrangements. This Interpretation will have no impact on the Bank.

IFRIC 13 "Customer Loyalty Programmes"

IFRIC Interpretation 13 was issued in June 2007 and becomes effective for annual periods beginning on or after 1 July 2008. This Interpretation requires customer loyalty award credits to be accounted for as a separate component of the sales transaction in which they are granted and therefore part of the fair value of the consideration received is allocated to the award credits and deferred over the period that the award credits are fulfilled. The Bank expects that this interpretation will have no impact on the Bank's financial statements as no such schemes currently exist.

IFRIC 14 "IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction"

IFRIC Interpretation 14 was issued in July 2007 and becomes effective for annual periods beginning on or after 1 January 2008. This Interpretation provides guidance on how to assess the limit on the amount of surplus in a defined benefit scheme that can be recognized as an asset under IAS 19 Employee Benefits. The Bank expects that this Interpretation will have no impact on the financial position or performance of the Bank.

4. Significant accounting 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:

(Thousands of Russian Rubles)

4. Significant accounting estimates (continued)

Allowance for impairment of factoring advances, loans and receivables

The Bank regularly reviews its factoring advances, loans and receivables to assess impairment. The Bank uses its experienced judgement to estimate the amount of any impairment loss in cases where a borrower is in financial difficulties and there are few available sources of historical data relating to similar borrowers. Similarly, the Bank estimates changes in future cash flows based on the observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the group of loans and receivables. The Bank uses its experienced judgement to adjust observable data for a group of factoring advances, loans or receivables to reflect current circumstances.

Salaries and employment benefits

Amount of annual bonus accrued represents estimated total bonus fund, and the actual amount will be calculated individually for each employee based on his performance, therefore in total it could differ from the cumulative estimate made by the management in these financial statements.

5. Cash and cash equivalents

Cash and cash equivalents comprise:

	<i>2007</i>	<i>2006</i>
Current accounts with the Central Bank	615,513	251,757
Current accounts with other credit institutions	181,172	202,938
Time deposits with credit institutions up to 90 days	1,363,070	200,214
Cash and cash equivalents	2,159,755	654,909

As of December 31, 2007, the Bank placed RUB 250,000 (2006 – RUB 200,000) as a deposit in RUB with a Russian bank and received RUB 250,000 (2006 – RUB 200,000) as a RUB deposit from the same bank's subsidiary (see Note 12).

6. Trading securities

Trading securities owned comprise Russian State bonds (OFZ) with coupon rate of 6.3% and maturity in 2008.

7. Amounts due from credit institutions

Amounts due from credit institutions comprise:

	<i>2007</i>	<i>2006</i>
Obligatory reserve with the Central Bank	336,966	230,650
Promissory notes	402,796	–
Time deposits for more than 90 days or overdue	146,269	–
Amounts due from credit institutions	886,031	230,650

Credit institutions are required to maintain a non-interest earning cash deposit (obligatory reserve) with the CBR, the amount of which depends on the level of funds attracted by the credit institution. The Bank's ability to withdraw such deposit is significantly restricted by the statutory legislation.

As of December 31, 2007, the Bank had unquoted promissory notes of Russian bank, which is the subsidiary of a large CIS bank in total amount of 402,796 RUB.

*(Thousands of Russian Rubles)***8. Derivative financial instruments**

The Bank enters into derivative financial instruments for trading purposes. The table below shows the fair values of derivative financial instruments, recorded as assets or liabilities, together with their notional amounts. The notional amount, recorded gross, is the amount of a derivative's underlying asset, reference rate or index and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding at the year end and are indicative of neither the market risk nor the credit risk.

	2007			2006		
	<i>Notional principal</i>	<i>Fair values</i>		<i>Notional principal</i>	<i>Fair value</i>	
		<i>Asset</i>	<i>Liability</i>		<i>Asset</i>	<i>Liability</i>
Foreign exchange contracts						
Forwards - domestic	711,840	1,730	–	1,260,711	–	23,176

As of 31 December 2007, the Bank has positions in the following types of derivatives:

Forwards and futures

Forwards contracts are contractual agreements to buy or sell a specified financial instrument at a specific price and date in the future. Forwards are customised contracts transacted in the over-the-counter market.

9. Factoring advances and loans

Factoring advances and loans comprise:

	2007	2006
Factoring advances with recourse	5,073,252	5,019,153
Factoring advances without recourse	2,306,380	1,160,383
Loans to customers	24,215	67,348
	7,403,847	6,246,884
Less – Clients counter-claims	(38,204)	(19,872)
	7,365,643	6,227,012
Less – Allowance for impairment	(314,287)	(239,486)
Factoring advances and loans to customers	7,051,356	5,987,526

Allowance for impairment of loans to customers

A reconciliation of the allowance for impairment of loans to customers by class is as follows:

	<i>Factoring advances with recourse 2007</i>	<i>Factoring advances without recourse 2007</i>	<i>Loans to customers 2007</i>	<i>Total 2007</i>
At 1 January 2007	219,712	19,774	–	239,486
Charge for the year	(1,253)	76,054	–	74,801
At 31 December 2007	218,459	95,828	–	314,287
Individual impairment	194,710	88,578	–	283,288
Collective impairment	23,749	7,250	–	30,999
	218,459	95,828	–	314,287
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	210,975	92,034	–	303,009

*(Thousands of Russian Rubles)***9. Factoring advances and loans (continued)**

	<i>Factoring advances with recourse 2006</i>	<i>Factoring advances without recourse 2006</i>	<i>Loans to customers 2006</i>	<i>Total 2006</i>
At 1 January 2006	160,835	5,834	–	166,669
Charge for the year	58,876	13,941	–	72,817
At 31 December 2006	219,711	19,775	–	239,486
Individual impairment	187,624	15,955	–	203,579
Collective impairment	32,087	3,820	–	35,907
	219,711	19,775	–	239,486
Gross amount of loans, individually determined to be impaired, before deducting any individually assessed impairment allowance	196,143	16,680	–	212,823

Individually impaired loans

Interest income accrued on loans, for which individual impairment allowances have been recognized, as at 31 December 2007, comprised RUB 4,786 (2006 – RUB 1,174).

Collateral and other credit enhancements

The amount of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented regarding the acceptability of valuation parameters.

The main types of collateral obtained are as follows:

- Guarantee agreements,
- The right of recourse, in case of event of default by the debtor.

Concentration of loans to customers

As of December 31, 2007, the Bank had a concentration of factoring advances and loans represented by RUB 2,119,617 due from the ten largest third party entities (29% of gross loan portfolio) (2006 – RUB 2,528,502, or 41%). An allowance of RUB 8,501 (2006 – RUB 20,396) was recognised against these advances and loans.

Factoring advances and loans are made principally within Russia in the following industry sectors:

	<i>2007</i>	<i>2006</i>
Production and wholesale of food and beverages	1,982,427	1,743,002
Other trading enterprises	1,766,292	1,336,792
Production and wholesale of computers and consumer electronics	1,575,278	1,719,342
Construction and finishing materials	910,951	526,125
Metallurgy and manufacturing	271,535	128,950
Individuals	24,215	–
Investment and finance	22,993	103,498
Chemistry and oil	13,792	272,831
Other	798,160	396,472
	7,365,643	6,227,012

*(Thousands of Russian Rubles)***10. Taxation**

The corporate income tax expense comprises:

	<u>2007</u>	<u>2006</u>
Current tax charge	110,595	114,842
Deferred tax charge/(credit) – origination and reversal of temporary differences	5,665	(14,112)
Income tax expense	<u>116,260</u>	<u>100,730</u>

The Bank is liable to profits tax in Russia on its taxable profit and capital gains other than profits on certain types of securities at a rate of 24%. Pursuant to Russian profits tax law interest income on certain types of securities is subject to profits tax at a rate of 15%, 9% or 0%.

The effective income tax rate differs from the statutory income tax rates. A reconciliation of the income tax expense based on statutory rates with actual is as follows:

	<u>2007</u>	<u>2006</u>
Profit before tax	417,408	402,583
Statutory tax rate	24%	24%
Theoretical income tax expense at the statutory rate	100,178	96,620
Income on state securities taxed at different rates (15%)	(116)	(115)
Non-deductible expenditures	16,198	4,225
Income tax expense	<u>116,260</u>	<u>100,730</u>

Tax assets and liabilities consist of the following:

	<u>2007</u>	<u>2006</u>
Deferred income tax assets	994	6,659
Current income tax liabilities	18,270	8,317

Deferred tax assets and liabilities years comprise:

	<u>2007</u>	<u>2006</u>
Tax effect of deductible temporary differences		
Factoring advances	6,139	5,654
Derivatives	–	5,562
Deferred tax assets	<u>6,139</u>	<u>11,216</u>
Tax effect of taxable temporary differences		
Derivatives	415	–
Borrowings	4,730	4,557
Deferred tax liabilities	<u>5,145</u>	<u>4,557</u>
Deferred tax liability (asset)	<u>(994)</u>	<u>(6,659)</u>

11. Other assets and liabilities

Other assets comprise:

	<i>Notes</i>	<u>2007</u>	<u>2006</u>
Advances to employees		127,600	–
Prepayments		31,581	33,895
Property and equipment, net		11,880	10,590
Prepaid operating taxes		9,574	2,864
Derivative financial assets	8	1,730	–
Intangible assets, net		407	38
Other		563	–
Other assets		<u>183,335</u>	<u>47,387</u>

*(Thousands of Russian Rubles)***11. Other assets and liabilities (continued)**

In 2007 the Bank granted advances to top management in total amount of 152,700 RUB. The advances are a part of management stimulation program, according to which advances are reimbursable if loyalty period of three and a half years is violated.

Other liabilities comprise:

	<u>2007</u>	<u>2006</u>
Operating taxes payable	26,458	15,849
Accrued additional compensation and other employee benefits	13,388	13,010
Time deposits of customers	504	–
Other	915	–
Other liabilities	<u>41,265</u>	<u>28,859</u>

12. Amounts due to credit institutions

Amounts due to credit institutions comprise:

	<u>2007</u>	<u>2006</u>
Time deposits and loans	6,152,923	3,644,468
Amounts due to credit institutions	<u>6,152,923</u>	<u>3,644,468</u>

As disclosed in Note 5, the Bank attracted RUB 250,000 (2006 – RUB 200,000) as a deposit in RUB from a Russian bank and placed RUB 250,000 (2006 – RUB 200,000) as a RUB deposit with the same bank's subsidiary.

13. Debt securities issued

Debt securities issued consisted of the following:

	<u>2007</u>	<u>2006</u>
Bonds	740,396	1,008,974
Credit linked notes	807,128	–
Debt securities issued	<u>1,547,524</u>	<u>1,008,974</u>

The Bank issued bonds on 4 May 2006, with maturity of three years and coupon interest rate of 9.8%. Nominal value of bonds is RUB 1,000,000.

In February 2007 the Bank attracted RUB 800,000 by issue of credit linked notes. The issue was organized by ING Bank N.V. The credit linked notes have coupon interest rate of 9.75% and mature in August 2008.

14. Equity

Movements in shares outstanding, issued and fully paid were as follows:

	<u>Number of ordinary shares</u>	<u>Nominal amount</u>
31 December 2007 and 2006	<u>1,456</u>	<u>1,456,000</u>

The share capital of the Bank was contributed by the shareholders in Russian Rubles and they are entitled to dividends and any capital distribution in Russian Rubles.

(Thousands of Russian Rubles)

14. Equity (continued)

In accordance with Russian legislation, dividends may only be declared to the shareholders of the Bank from accumulated undistributed and unreserved earnings as shown in the Bank's financial statements prepared in accordance with RAL. The Bank had approximately RUB 386,453 of undistributed and unreserved earnings as at 31 December 2007 (2006 – RUB 561,647). As of the date of issue of these financial statement the shareholders of the Bank have not declared any dividend payments.

Statutory general reserve

The statutory general reserve is created as required by the regulations of the Russian Federation, in respect of general banking risks, including future losses and other unforeseen risks or contingencies. The reserve has been created in accordance with the Bank's charter, which provides for the creation of a reserve for these purposes of not less than 5% of the Bank's share capital reported in accordance with RAL.

15. Commitments and contingencies

Operating environment

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.

Legal

In the ordinary course of business, the Bank is subject to legal actions and complaints. Management believes that the ultimate liability, if any, arising from such actions or complaints will not have a material adverse effect on the financial condition or the results of future operations of the Bank.

Taxation

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 Bank 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. 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.

As at 31 December 2007 management believes that its interpretation of the relevant legislation is appropriate and that the Bank's tax, currency and customs positions will be sustained.

Financial commitments and contingencies

As of December 31, 2007 the Bank's financial commitments and contingencies comprised the following:

	<u>2007</u>	<u>2006</u>
Credit related commitments		
Guarantees	436,072	148,342
	<u>436,072</u>	<u>148,342</u>
Operating lease commitments		
Not later than 1 year	59,563	56,040
Later than 1 year but not later than 5 years	28,643	59,478
	<u>88,206</u>	<u>115,518</u>
Financial commitments and contingencies	<u>524,278</u>	<u>263,860</u>

Insurance

The Bank has not currently obtained insurance coverage related to liabilities arising from errors or omissions. Liability insurance is generally not available in Russia at present.

*(Thousands of Russian Rubles)***16. Interest income from factoring operations**

Interest income from factoring operations comprise the following types:

	<u>2007</u>	<u>2006</u>
Financing income	882,308	637,420
Service premium	363,443	317,444
Risk premium	110,594	30,259
Interest income from factoring operations	<u>1,356,345</u>	<u>985,123</u>

17. Personnel and other operating expenses

Personnel and other operating expenses comprise:

	<u>2007</u>	<u>2006</u>
Salaries and bonuses	230,312	172,154
Social security costs	31,042	23,938
Deferred employee benefit expense	25,100	—
Personnel expenses	<u>286,454</u>	<u>196,092</u>
Occupancy and rent	75,316	67,497
Legal and consultancy	28,264	11,479
Business travel and related	19,592	14,840
Marketing and advertising	12,454	8,942
Communications	10,598	6,648
Information technology	4,290	1,698
Operating taxes	4,136	1,813
Repair and maintenance of property and equipment	2,700	2,044
Personnel training	2,274	1,072
Security	1,821	1,211
Office supplies	1,493	1,376
Other	16,334	10,106
Administrative and operating expenses	<u>179,272</u>	<u>128,726</u>

18. Risk management

Risk is inherent in Bank's activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Bank's continuing profitability and each individual within the Bank is accountable for the risk exposures relating to his or her responsibilities. The Bank is exposed to credit risk, liquidity risk and market risk, the latter being subdivided into trading and non-trading risks. It is also subject to operating risks.

The independent risk control process does not include business risks such as changes in the environment, technology and industry. They are monitored through the Bank's strategic planning process.

Goals and objectives of risk management system:

- Protection of shareholders' interests by securing proper level of the Bank financial strength, by arranging monitoring system, which is in line with nature and size of the Bank's operations as well as optimization of risks in all areas of activities.
- Determination of priorities in the Bank's risk management. Defining maximum allowable risk values (risk appetite) adopted by the Bank.
- Maintaining the Bank's aggregate risk level within the limits of value of the risk appetite determined in the Risk Management Policy.
- Establishing efficient risk management in the Bank, increasing the Bank's investment attractiveness both for Russian and foreign investors.
- Securing uniform approaches to risk management within the entire Bank.

(Thousands of Russian Rubles)

18. Risk management (continued)

Definition of key areas the risk management in the Bank:

- Identification of the Bank's risks.
- Determining risk management methods.
- Direct risk management by means of risk management divisions.
- Securing independence of risk management divisions from business divisions.
- Information support for all risk management divisions and the Bank's Internal Audit department.

Main principles of establishing the risk management system.

Changeover to an integrated uniform approach within the entire Bank to establishing risk management procedure, first of all with regard to identifying all substantial risks, development of methods and procedures for their evaluation, monitoring and reduction (prevention) with the purpose of ensuring the required growth rate of the Bank's business value.

Risk management provides for implementation of the uniform methods for evaluation of risks taken by the Bank's business units.

Risk management system has been developed with due account for legislative acts and regulatory documents of the Central Bank of Russia, which are in force or under consideration. Approaches to risk control and risk management within the Bank are based on recommendations and usage of the world best practices.

Day-to-day risk management in the Bank is performed by the following divisions within the scope of their authorities:

- the Bank's divisions generating risks, including business units (Sales divisions, Client operations divisions), Treasury, Back office.
- Special-purpose risk management divisions, whose main tasks are risk management, including Department of Combined Underwriting, All-Corporate Risk Monitoring Department, Financial Risks Analysis Department.
- other divisions of the Bank, whose activities may limit and/or eliminate risks taken by the Bank, including Credit Control Department, Legal Department, Internal Audit etc.

Organization of Bank's risk management system

Bank's day-to-day risk management system is a centralized hierarchic management system, which provides for risk management with regard to separate types of risk irrespective of types of activities (performed by business units), which generate these risks, consisting of the following levels:

Risk management strategy is determined by the Board of directors by approving Risk management strategy (including determination of risk appetite), and the Chairman of the Management Board is responsible for implementation of the approved strategy.

Tactic risk management is performed by Bank's collegiate bodies within the scope of their authorities, including:

- Risk Management Committee – takes decisions on methodological issues of risk management as well as working conditions in specific industry sectors or decisions on non-typical conditions of factoring services rendered to Clients. Inter alia, Risk management committee is entitled to take decisions on issues being within the competence of Risk Monitoring Committee and Underwriting Committee, since Risk Management Committee is a collegiate body of a higher level than Risk Monitoring Committee and Underwriting Committee. Decisions taken by Risk Management Committee may not be cancelled/amended by Risk Monitoring Committee and Underwriting Committee.
- Risk Monitoring Committee takes decisions on selection of clients, conditions of their servicing as well as termination, renewal or continuation of their servicing on the former or amended terms based on the results of planned or unplanned monitoring.
- Underwriting Committee takes decisions on large amounts of limits set on Debtors.
- Credit Committee takes decisions on assuming and regulating credit risks, which are not related to factoring operations.

Day-to-day risk management is performed (within the scope of authorities) by Risk management divisions and other divisions of the Bank under their competence.

(Thousands of Russian Rubles)

18. Risk management (continued)

Risk management procedure:

- Identification — detection of risks;
- Assessment — evaluation of risk in accordance with the methods accepted by the Bank. Assessment is performed by the Bank's relevant collegiate bodies, business units, risk management divisions and other divisions of the Bank within the scope of their competence;
- Restriction/management — is performed in accordance with the methods accepted by the Bank. Risk restriction/management is performed by the Bank's relevant collegiate bodies, business units, risk management divisions and other divisions of the Bank within the scope of their competence;
- Monitoring — control of the current risk level is performed by risk management divisions, internal audit, collegiate bodies and business units within the scope of their competence.

Methods applied in risk management.

- Regulation of operations – development of procedures;
- Setting-up limits on operations, counterparties, issuers, losses etc.;
- Diversification of operations;
- Estimation of adequate loan loss allowance;
- Control of established procedures and restrictions;
- Development of scenarios regarding the Bank's risk management in emergency situations.

Specific methods for management of every single type of risk, which is crucial to Bank, are determined in methods, principles and normative acts regulating the relevant risk management.

Credit risk

Credit risk is the risk that the Bank will incur a loss because its customers, clients or counterparties failed to discharge their contractual obligations. The Bank manages and controls credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and for geographical and industry concentrations, and by monitoring exposures in relation to such limits.

The Bank has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions. Counterparty limits are established by the use of a credit risk classification system, which assigns each counterparty a risk rating. Risk ratings are subject to regular revision. The credit quality review process allows the Bank to assess the potential loss as a result of the risks to which it is exposed and take corrective action.

Derivative financial instruments

Credit risk arising from derivative financial instruments is, at any time, limited to those with positive fair values, as recorded in the balance sheet.

Credit-related commitments risks

The Bank makes available to its customers guarantees which may require that the Bank make payments on their behalf. Such payments are collected from customers based on the terms of the letter of credit. They expose the Bank to similar risks to loans and these are mitigated by the same control processes and policies.

The table below shows the maximum exposure to credit risk for the components of the balance sheet, including derivatives. The maximum exposure is shown gross, before the effect of mitigation through the use of master netting and collateral agreements.

*(Thousands of Russian Rubles)***18. Risk management (continued)****Credit risk (continued)**

	<i>Notes</i>	<i>Gross maximum exposure 2007</i>	<i>Gross maximum exposure 2006</i>
Cash and cash equivalents	5	2,159,755	654,909
Trading securities	6	20,638	20,711
Amounts due from credit institutions	7	886,031	230,650
Factoring advances and loans	9	7,051,356	5,987,526
Derivative financial assets	8	1,730	–
Prepayments	11	31,581	33,895
		<u>10,151,091</u>	<u>6,927,691</u>
Financial commitments and contingencies	15	436,072	148,342
Total credit risk exposure		<u><u>10,587,163</u></u>	<u><u>7,076,033</u></u>

Where financial instruments are recorded at fair value, the amounts shown above represent the current credit risk exposure but not the maximum risk exposure that could arise in the future as a result of changes in values.

The effect of collateral and other risk mitigation techniques is shown below.

Credit quality per class of financial assets

The credit quality of financial assets is managed by the Bank internal credit ratings. The table below shows the credit quality by class of asset for loan-related balance sheet lines, based on the Bank's credit rating system.

	<i>Notes</i>	<i>Neither past due nor impaired</i>			<i>Past due or individually impaired 2007</i>	<i>Total 2007</i>
		<i>High grade 2007</i>	<i>Standard grade 2007</i>	<i>Sub-standard grade 2007</i>		
Amounts due from credit institutions	7	886,031	–	–	–	886,031
Factoring advances and loans	9					
Factoring advances with recourse		2,240,424	2,513,521	93,069	226,238	5,073,252
Factoring advances without recourse		124,869	2,043,355	456	99,496	2,268,176
Loans to customers		24,215	0	0	0	24,215
		<u>2,389,508</u>	<u>4,556,876</u>	<u>93,525</u>	<u>325,734</u>	<u>7,365,643</u>
Total		<u><u>3,275,539</u></u>	<u><u>4,556,876</u></u>	<u><u>93,525</u></u>	<u><u>325,734</u></u>	<u><u>8,251,674</u></u>

	<i>Notes</i>	<i>Neither past due nor impaired</i>			<i>Past due or individually impaired 2006</i>	<i>Total 2006</i>
		<i>High grade 2006</i>	<i>Standard grade 2006</i>	<i>Sub-standard grade 2006</i>		
Amounts due from credit institutions	7	230,650	–	–	–	230,650
Factoring advances and loans	9					
Factoring advances with recourse		1,323,017	3,452,963	38,388	204,785	5,019,153
Factoring advances without recourse		135,797	987,769	265	16,680	1,140,511
Loans to customers		67,348				67,348
		<u>1,526,162</u>	<u>4,440,732</u>	<u>38,653</u>	<u>221,465</u>	<u>6,227,012</u>
Total		<u><u>1,756,812</u></u>	<u><u>4,440,732</u></u>	<u><u>38,653</u></u>	<u><u>221,465</u></u>	<u><u>6,457,662</u></u>

(Thousands of Russian Rubles)

18. Risk management (continued)

Credit risk (continued)

Past due factoring advances and loans to customers include those that are only past due by a few days. An analysis of past due loans, by age, is provided below. The majority of the past due loans are not considered to be impaired.

It is the Bank's policy to maintain accurate and consistent risk ratings across the credit portfolio. This facilitates focused management of the applicable risks and the comparison of credit exposures across all lines of business, geographic regions and products. The rating system is supported by a variety of financial analytics, combined with processed market information to provide the main inputs for the measurement of counterparty risk. All internal risk ratings are tailored to the various categories and are derived in accordance with the Bank's rating policy. The attributable risk ratings are assessed and updated regularly.

Ageing analysis of past due but not impaired loans per class of financial assets

	<i>Less than 30 days 2007</i>	<i>31 to 90 days 2007</i>	<i>More than 90 days 2007</i>	<i>Total 2007</i>
Factoring advances and loans				
Factoring advances with recourse	6,796	7,840	4,493	19,129
Factoring advances without recourse	3,303	–	293	3,596
Total	10,099	7,840	4,786	22,725
	<i>Less than 30 days 2006</i>	<i>31 to 90 days 2006</i>	<i>More than 90 days 2006</i>	<i>Total 2006</i>
Factoring advances and loans				
Factoring advances with recourse	7,470	–	1,172	8,642
Factoring advances without recourse	–	–	–	–
Total	7,470	–	1,172	8,642

See Note 9 for more detailed information with respect to the allowance for impairment of loans to customers.

Carrying amount per class of financial assets whose terms have been renegotiated

Once the terms have been renegotiated, the loan is no longer considered past due. Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original effective interest rate.

The bank usually doesn't change conditions of the contract with clients and doesn't conclude agreements on change of term of recourse. Factoring activity does not provide such conditions.

As of December 31, 2007 the carrying amount of renegotiated financial assets equals RUB 81,941.

Impairment assessment

The main considerations for the loan impairment assessment include whether any payments of principal or interest are overdue by more than 30 days or there are any known difficulties in the cash flows of counterparties, credit rating downgrades, or infringement of the original terms of the contract. The Bank addresses impairment assessment in two areas: individually assessed allowances and collectively assessed allowances.

Individually assessed allowances

The Bank determines the allowances appropriate for each individually significant loan on an individual basis. Items considered when determining allowance amounts include the sustainability of the counterparty's business plan, its ability to

*(Thousands of Russian Rubles)***18. Risk management (continued)****Credit risk (continued)**

improve performance once a financial difficulty has arisen, projected receipts and the expected dividend payout should bankruptcy ensue, the availability of other financial support and the realisable value of collateral, and the timing of the expected cash flows. The impairment losses are evaluated at each reporting date, unless unforeseen circumstances require more careful attention.

Collectively assessed allowances

Allowances are assessed collectively for losses on factoring advances and loans to customers that are not individually significant and for individually significant factoring advances and loans where there is not yet objective evidence of individual impairment. Allowances are evaluated on each reporting date with each portfolio receiving a separate review.

The collective assessment takes account of impairment that is likely to be present in the portfolio even though there is no yet objective evidence of the impairment in an individual assessment. Impairment losses are estimated by taking into consideration of the following information: historical losses on the portfolio, current economic conditions, the appropriate delay between the time a loss is likely to have been incurred and the time it will be identified as requiring an individually assessed impairment allowance, and expected receipts and recoveries once impaired. Local management is responsible for deciding the length of this period which can extend for as long as one year. The impairment allowance is then reviewed by credit management to ensure alignment with the Bank's overall policy.

The geographical concentration of Bank's monetary assets and liabilities is set out below:

	2007				2006			
	Russia	OECD	CIS and other foreign banks	Total	Russia	OECD	CIS and other foreign banks	Total
Assets:								
Cash and cash equivalents	2,159,755	–	–	2,159,755	654,909	–	–	654,909
Trading securities	20,638	–	–	20,638	20,711	–	–	20,711
Amounts due from credit institutions	886,031	–	–	886,031	230,650	–	–	230,650
Factoring advances and loans	7,017,738	–	33,618	7,051,356	5,957,556	–	29,970	5,987,526
Other assets	184,329	–	–	184,329	54,046	–	–	54,046
	<u>10,268,491</u>	<u>–</u>	<u>33,618</u>	<u>10,302,109</u>	<u>6,917,872</u>	<u>–</u>	<u>29,970</u>	<u>6,947,842</u>
Liabilities:								
Amounts due to credit institutions	5,166,924	985,999	–	6,152,923	2,624,875	1,019,593	–	3,644,468
Derivative financial liabilities	–	–	–	–	23,176	–	–	23,176
Debt securities issued	740,395	807,129	–	1,547,524	1,008,974	–	–	1,008,974
Settlements with clients on factoring	114,918	–	–	114,918	107,987	–	–	107,987
Other liabilities	59,535	–	–	59,535	37,176	–	–	37,176
	<u>6,081,772</u>	<u>1,793,128</u>	<u>–</u>	<u>7,874,900</u>	<u>3,802,188</u>	<u>1,019,593</u>	<u>–</u>	<u>4,821,781</u>
Net balance sheet position	<u>4,186,718</u>	<u>(1,793,128)</u>	<u>33,618</u>	<u>2,427,209</u>	<u>3,115,684</u>	<u>(1,019,593)</u>	<u>29,970</u>	<u>2,126,061</u>
Net off-balance sheet position	524,278	–	–	524,278	263,860	–	–	263,860

Liquidity risk and funding management

Liquidity risk is the risk that the Bank will be unable to meet its payment obligations when they fall due under normal and stress circumstances. To limit this risk, management has arranged diversified funding sources in addition to its core funding base, manages assets with liquidity in mind, and monitors future cash flows and liquidity on a daily basis. This incorporates an assessment of expected cash flows and the availability of high grade collateral which could be used to secure additional funding if required.

*(Thousands of Russian Rubles)***18. Risk management (continued)****Liquidity risk and funding management (continued)***Analysis of financial liabilities by remaining contractual maturities*

The table below summarises the maturity profile of the Bank's financial liabilities at 31 December 2007 based on contractual undiscounted repayment obligations.

Financial liabilities	2007				
	<i>Less than 1 months</i>	<i>1 to 3 months</i>	<i>3 to 12 months</i>	<i>1 to 5 Years</i>	<i>Total</i>
Amounts due to credit institutions	3,018,972	1,601,646	1,471,359	220,147	6,312,124
Debt securities issued	–	37,773	893,017	769,487	1,700,277
Settlements with clients on factoring	114,918	–	–	–	114,918
Time deposits of clients	–	504	–	–	504
Total undiscounted financial liabilities	3,133,890	1,639,923	2,364,376	989,634	8,127,823

Financial liabilities	2006				
	<i>Less than 1 months</i>	<i>1 to 3 months</i>	<i>3 to 12 months</i>	<i>1 to 5 Years</i>	<i>Total</i>
Amounts due to credit institutions	1,119,830	1,120,428	1,515,762	–	3,756,020
Derivative financial liabilities	4,741	4,430	14,005	–	23,176
Debt securities issued	–	24,701	74,104	1,148,208	1,247,013
Settlements with clients on factoring	107,987	–	–	–	107,987
Total undiscounted financial liabilities	1,232,558	1,149,559	1,603,871	1,148,208	5,134,196

The table below shows the contractual expiry by maturity of the Bank's financial commitments and contingencies.

	<i>Less than 1 months</i>	<i>1 to 3 months</i>	<i>3 to 12 months</i>	<i>1 to 5 years</i>	<i>Total</i>
2007	437,340	15,130	43,165	28,643	524,278
2006	149,243	14,427	40,712	59,478	263,860

The Bank expects that not all of the contingent liabilities or commitments will be drawn before expiry of the commitments.

Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates, foreign exchanges, and equity prices.

Market risk – Non - trading*Interest rate risk*

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments. The following table demonstrates the sensitivity to a reasonably possible change in interest rates, with all other variables held constant, of the Bank's income statement.

The sensitivity of the income statement is the effect of the assumed changes in interest rates on the net interest income for one year, based on the floating rate non-trading financial assets and financial liabilities held at 31 December 2007.

Currency	<i>Increase in basis points 2007</i>	<i>Sensitivity of net interest income 2007</i>	<i>Sensitivity of equity 2007</i>
RUR	+100	(3,182)	(3,182)
USD	+75	(9,849)	(9,849)

*(Thousands of Russian Rubles)***18. Risk management (continued)****Market risk – Non - trading (continued)**

<i>Currency</i>	<i>Decrease in basis points 2007</i>	<i>Sensitivity of net interest income 2007</i>	<i>Sensitivity of equity 2007</i>
RUR	-150	4,773	4,773
USD	-125	16,415	16,415

<i>Currency</i>	<i>Increase in basis points 2006</i>	<i>Sensitivity of net interest income 2006</i>	<i>Sensitivity of equity 2006</i>
RUR	+100	(5,000)	(5,000)
USD	+50	(6,583)	(6,583)

<i>Currency</i>	<i>Decrease in basis points 2006</i>	<i>Sensitivity of net interest income 2006</i>	<i>Sensitivity of equity 2006</i>
RUR	-100	5,000	5,000
USD	-100	13,166	13,166

The Bank has financial commitments with floating interest rate. These financial commitments are not hedged by appropriate assets, because the main part of the Bank's assets has short maturity period, so Bank has a possibility to proactively manage its interest rate risk. Factoring agreements concluded with clients contain a provision about the unilaterally interest rate changes by the Bank.

The Bank's average effective interest rates for monetary financial instruments at December 31 follow.

	<i>2007</i>			<i>2006</i>		
	<i>Rubles</i>	<i>USD</i>	<i>Other foreign currencies</i>	<i>Rubles</i>	<i>USD</i>	<i>Other foreign currencies</i>
Cash and cash equivalents	6.9%	6.4%	5.4%	6.5%	–	–
Trading securities	6.3%	–	–	6.3%	–	–
Amounts due from credit institutions	11.0%	7.1%	6.0%	–	–	–
Factoring advances and loans	21.4%	20.9%	16.5%	22.0%	21.4%	15.9%
Amounts due to credit institutions	8.2%	8.2%	4.8%	7.9%	7.3%	4.5%
Debt securities issued	10.4%	–	–	–	–	–

Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Management Board has set limits on positions by currency based on the CBR regulations. Positions are monitored on a daily basis.

The tables below indicate the currencies to which the Bank had significant exposure at 31 December 2007 and 2006 on its non-trading monetary assets and liabilities and its forecast cash flows. The analysis calculates the effect of a reasonably possible movement of the currency rate against the Rouble, with all other variables held constant on the income statement (due to the fair value of currency sensitive non-trading monetary assets and liabilities). A negative amount in the table reflects a potential net reduction in income statement or equity, while a positive amount reflects a net potential increase.

*(Thousands of Russian Rubles)***18. Risk management (continued)**

<i>Currency</i>	<i>Change in currency rate in % 2007</i>	<i>Effect on profit before tax 2007</i>	<i>Change in currency rate in % 2006</i>	<i>Effect on profit before tax 2006</i>
USD	6,2%	(7,006)	5,6%	(2,910)
USD	-4,0%	4,519	-3,6%	1,871
EUR	5,7%	413	6,5%	661
EUR	-3,7%	(225)	-3,8%	(387)

Operational risk

Operational risk is the risk of loss arising from systems failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Bank cannot expect to eliminate all operational risks, but through a control framework and by monitoring and responding to potential risks, the Bank is able to manage the risks. Controls include effective segregation of duties, access, authorisation and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

19. Fair values of financial instruments

Set out below is a comparison by class of the carrying amounts and fair values of the Bank's financial instruments that are carried in the financial statements. The table does not include the fair values of non-financial assets and non-financial liabilities.

	<i>Carrying value 2007</i>	<i>Fair value 2007</i>	<i>Unrecognised gain/(loss) 2007</i>	<i>Carrying value 2006</i>	<i>Fair value 2006</i>	<i>Unrecognised gain/(loss) 2006</i>
Financial assets						
Cash and Cash equivalents	2,159,755	2,159,755	–	654,909	654,909	–
Trading securities	20,638	20,638	–	20,711	20,711	–
Amounts due from credit institutions	886,031	886,482	451	230,650	230,650	–
Factoring advances and loans	7,051,356	7,063,561	12,205	5,987,526	5,941,745	45,781
Deferred income tax assets	994	994	–	6,659	6,659	–
Other assets	183,335	154,795	(28,540)	47,387	47,387	–
	10,302,109	10,286,225	(15,884)	6,947,842	6,902,061	45,781
Financial liabilities						
Amounts due to credit institutions	6,152,923	6,156,102	(3,179)	3,644,468	3,668,293	(23,825)
Debt securities issued	1,547,524	1,550,899	(3,375)	1,008,974	1,007,545	1,429
Settlements with clients on factoring	114,918	114,918	–	107,987	107,987	–
Other Liabilities	59,535	59,535	–	60,352	60,352	–
	7,874,900	7,881,454	(6,554)	4,821,781	4,844,177	(22,396)

The following describes the methodologies and assumptions used to determine fair values for those financial instruments which are not already recorded at fair value in the financial statements.

Assets for which fair value approximates carrying value

For financial assets and financial liabilities that are liquid or having a short term maturity (less than three months) it is assumed that the carrying amounts approximate to their fair value. This assumption is also applied to demand deposits, savings accounts without a specific maturity and variable rate financial instruments.

Fixed rate financial instruments

The fair value of fixed rate financial assets and liabilities carried at amortised cost are estimated by comparing market interest rates when they were first recognised with current market rates offered for similar financial instruments. The estimated fair

*(Thousands of Russian Rubles)***19. Fair values of financial instruments (continued)**

value of fixed interest bearing deposits is based on discounted cash flows using prevailing money-market interest rates for debts with similar credit risk and maturity. For quoted debt issued the fair values are calculated based on quoted market prices. For those notes issued where quoted market prices are not available, a discounted cash flow model is used based on a current interest rate yield curve appropriate for the remaining term to maturity.

Financial instruments recorded at fair value

The following table shows an analysis of financial instruments recorded at fair value, between those whose fair value is based on quoted market prices.

	<u>Quoted market price 2007</u>	<u>Quoted market price 2006</u>
Financial assets		
Derivative financial instruments	1,730	–
Trading securities	20,638	20,711
	<u>22,368</u>	<u>20,711</u>
Financial liabilities		
Derivative financial instruments	–	23,176
		<u>23,176</u>

20. Related party disclosures

In accordance with IAS 24 “Related Party Disclosures”, parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

Related parties may enter into transactions which unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties.

The volumes of related party transactions, outstanding balances at the year end, and related expense and income for the year are as follows:

	<u>2007</u>		<u>2006</u>	
	<i>Entities under common control (Financial Corporation Uralsib)</i>	<i>Key management personnel</i>	<i>Entities under common control (Financial Corporation Uralsib)</i>	<i>Key management personnel</i>
Cash and cash equivalents	319,215	–	108,444	–
Factoring advances and loans at January 1	118,168	–	36,036	–
Loans issued during the year	2,470,500	712	534,330	–
Factoring advances and loans repaid during the year	2,567,168	119	452,198	–
Factoring advances and loans at December 31, gross	21,500	593	118,168	–
Less: allowance for impairment at December 31	–	–	(1,099)	–
Factoring advances and loans at December 31, net	21,500	–	117,069	–
Interest income on factoring advances and loans	21,307	31	8,905	–
Impairment of interest earning assets	1,099	–	638	–
Amounts due to credit institutions	2,822,072	–	1,220,994	–
Time deposits	504	–	–	–
Interest expense	130,763	–	33,055	–
Other assets		127,599		
Salaries and employment benefits	–	66,649	–	29,556

(Thousands of Russian Rubles)

21. Capital

The Bank maintains an actively managed capital base to cover risks inherent in the business. The adequacy of the Bank's capital is monitored using, among other measures, the ratios established by the Basel Capital Accord 1988 and the ratios established by the CBR in supervising the Bank.

During the past year, the Bank had complied in full with all its externally imposed capital requirements.

The primary objectives of the Bank's capital management are to ensure that the Bank complies with externally imposed capital requirements and that the Bank maintains strong credit ratings and healthy capital ratios in order to support its business and to maximise shareholders' value.

The Bank manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Bank may adjust the amount of dividend payment to shareholders, return capital to shareholders or issue capital securities. No changes were made in the objectives, policies and processes from the previous years.

CBR capital adequacy ratio

The CBR requires banks to maintain a capital adequacy ratio of 10% of risk-weighted assets, computed based on RAL. As of 31 December 2007 and 2006, the Bank's capital adequacy ratio on this basis was as follows:

	<u>2007</u>	<u>2006</u>
Main capital	1,890,173	1,738,209
Additional capital	269,719	295,537
Less: deductions from capital	907	232
Total capital	<u>2,158,985</u>	<u>2,033,514</u>
Risk weighted assets	<u>11,303,586</u>	<u>7,394,596</u>
Capital adequacy ratio	19.1%	27.5%

Regulatory capital consists of Tier 1 capital, which comprises share capital, share premium, retained earnings including current year profit and foreign currency translation. Certain adjustments are made to IFRS-based results and reserves, as prescribed by the Central Bank.

Capital adequacy ratio under Basel Capital Accord 1988

The Bank's capital adequacy ratio, computed in accordance with the Basel Capital Accord 1988, with subsequent amendments including the amendment to incorporate market risks, as of 31 December 2007 and 2006, comprised:

	<u>2007</u>	<u>2006</u>
Tier 1 capital	2,427,209	2,128,287
Tier 2 capital	-	-
Total capital	<u>2,427,209</u>	<u>2,128,287</u>
Risk weighted assets	<u>8,344,982</u>	<u>6,490,512</u>
Tier 1 capital ratio	29.09%	32.79%
Total capital ratio	29.09%	32.79%

22. Events after the balance sheet date

The Board of Directors approved a decision to register prospectus for issuance of Russian rouble bonds with total nominal value of RUB 4,000,000 and maturity 3 year.

Ernst & Young

Assurance | Tax & Legal | Transactions | Advisory

About Ernst & Young

Ernst & Young is a global leader in assurance, tax, transaction and advisory services.

Worldwide, our 130,000 people are united by our shared values and an unwavering commitment to quality. We make a difference by helping our people, our clients and our wider communities achieve potential.

For more information, please visit www.ey.com.

Ernst & Young refers to the global organization of member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients.

www.ey.com/cis

© 2008 CJSC Ernst & Young Vneshaudit
All Rights Reserved.

