OAO Mosenergo

Consolidated Financial Statements
for the year ended 31 December 2006

PRICEWATERHOUSECOOPERS

ZAO PricewaterhouseCoopers Audit
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INDEPENDENT AUDITOR'S REPORT

To the Shareholders and the Board of Directors of OAO "Mosenergo":

1 We have audited the accompanying consolidated financial statements of OAO "Mosenergo" and its subsidiaries (the "Group") which comprise the consolidated balance sheet as at 31 December 2006 and the consolidated income statement, consolidated statement of changes in equity and consolidated statement of cashflows for the year then ended and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

2 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 financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

3 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 financial statements are free from material misstatement.

4 An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the 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.

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

Opinion

6 In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Group 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.

ZAO PricewaterhouseCoopers Audit

Moscow, Russian Federation
16 April 2007

(in millions of Russian Roubles)

	Note	31 December 2006	31 December 2005
Non-current assets			
Property, plant and equipment	4	59 679	38 155
Investments in associates	5	346	328
Other non-current assets	6	215	82
Total non-current assets		**60 240**	**38 565**
Current assets			
Cash and cash equivalents	10	5 729	2 383
Accounts receivable and prepayments	9	4 921	5 950
Current profit tax prepayments		56	1 175
Inventories	7	4 346	2 966
Other current assets	8	666	679
Total current assets		**15 718**	**13 153**
Total assets		**75 958**	**51 718**
EQUITY AND LIABILITIES			
Equity	11		
Share capital			
Ordinary shares (nominal value RR 28 249 million)		154 624	154 624
Accumulated loss		(115 510)	(123 633)
Total equity		**39 114**	**30 991**
Non-current liabilities			
Deferred profit tax liabilities	13	6 291	3 993
Loans and borrowings	12	20 438	-
Total non-current liabilities		**26 729**	**3 993**
Current liabilities			
Loans and borrowings	12	580	9 814
Accounts payable and accrued charges	15	7 737	5 043
Current profit tax payable		723	9
Other taxes payable	16	1 075	1 868
Total current liabilities		**10 115**	**16 734**
Total liabilities		**36 844**	**20 727**
Total equity and liabilities		**75 958**	**51 718**

Chairman of the Management Board A.Y. Kopsov

Chief Accountant T.P. Dronova

16 April 2007

(in millions of Russian Roubles)

	Note	Period ended 31 December 2006	Period ended 31 December 2005
Revenue			
Electricity		30 905	40 294
Heating		31 684	27 539
Other		4 654	2 884
Total revenues		**67 243**	**70 717**
Other operating income		93	1 276
Operating expenses			
Fuel expenses		(33 303)	(29 552)
Transmission fees		(11 358)	(5 751)
Wages and payroll taxes		(6 651)	(8 550)
Depreciation of property, plant and equipment	4	(3 812)	(5 612)
Repairs and maintenance		(2 242)	(4 465)
Taxes other than income		(1 370)	(1 650)
Other materials		(641)	(933)
Subscription fees/Electricity & heat distribution expenses		(557)	(1 604)
Insurance cost		(479)	(691)
Water payments		(342)	(436)
Purchased power and heat		(305)	(3 913)
Labor protection costs		(273)	(417)
Security expenses		(242)	(202)
Social expenditure		(53)	(319)
(Charge)/reverse of impairment of trade and other receivables		84	(745)
Loss on disposal of subsidiary		-	(338)
Commission fee		-	(456)
Expenses related to restructuring process		-	(324)
Release of impairment provision for property, plant and equipment		10 532	-
Other expenses		(3 287)	(4 423)
Total operating expenses		**(54 299)**	**(70 381)**
Operating profit		**13 037**	**1 612**
Financial expenses, net	17	(363)	(1 125)
Share of profit of associate		18	79
Profit before profit tax		**12 692**	**566**
Profit tax expense	13	(4 096)	(825)
Profit/ (loss) for the year		**8 596**	**(259)**
Attributable to:			
Shareholders of OAO Mosenergo		8 596	(289)
Minority interest		-	30
Earnings /(loss)per ordinary share for earnings/(loss) attributable to the shareholders of OAO Mosenergo – basic and diluted (in Russian Roubles)	14	**0.30**	**(0.01)**

Chairman of the Management Board — A.Y. Kopsov

Chief Accountant — T.P. Dronova

16 April 2007

(in millions of Russian Roubles)

	Note	Period ended 31 December 2006	Period ended 31 December 2005
CASH FLOW FROM OPERATING ACTIVITIES:			
Profit before profit tax		**12 692**	**566**
Adjustments to reconcile profit before profit tax to net cash provided by operations:			
Depreciation of property, plant and equipment	4	3 812	5 612
Reversal of impairment provision for property, plant and equipment	4	(10 532)	-
Interest income	17	(63)	-
Interest expense	17	526	1 066
Foreign exchange (gain)/loss	17	(100)	59
Charge (release) of Trade and other receivables impairment provision		(84)	745
Share of net income from associated undertakings	5	(18)	(79)
Loss on disposal of property, plant and equipment		3	10
Loss on disposal of subsidiary		-	338
Non-cash additions to property, plant and equipment	4	-	(1 032)
Adjustments for other non-cash activities		(310)	(713)
Operating cash flows before working capital changes and profit tax paid		**5 926**	**6 572**
Working capital changes:			
Increase in inventories		(1 305)	(259)
Decrease/ (Increase) in accounts receivable and prepayments		1 188	(3 626)
Decrease in other current assets		13	1 335
(Increase)/ Decrease in other non-current assets		(134)	799
Increase in accounts payable and accrued charges, excluding Capital expenditure		1 610	285
Decrease in taxes payable, other than profits tax		(892)	(1 500)
Profit tax paid		(720)	(3 849)
Profit tax reimbursed		854	-
Net cash provided by (used for) operating activities		**6 540**	**(243)**
CASH FLOW FROM INVESTING ACTIVITIES:			
Additions to property, plant and equipment		(13 241)	(3 178)
Proceeds from sale of property, plant and equipment		19	253
Interest paid and capitalized	4	(591)	
Cash disposed of through spin-off		-	(954)
Proceeds from sales of subsidiary, net of cash disposed of		-	(1 296)
Net cash used for investing activities		**(13 813)**	**(5 175)**
CASH FLOW FROM FINANCING ACTIVITIES:			
Proceeds from borrowings		41 683	32 010
Repayment of borrowings		(30 351)	(28 696)
Interest paid		(259)	(1 170)
Proceeds from treasury shares		-	21
Dividends paid		(454)	(624)
Net cash generated by (used for) financing activities		**10 619**	**1 541**
Increase/(decrease) in cash and cash equivalents		**3 346**	**(3 877)**
Cash and cash equivalents at the beginning of the period	10	**2 383**	**6 260**
Cash and cash equivalents at the end of the period	10	**5 729**	**2 383**

Chairman of the Management Board A.Y. Kopsov

Chief Accountant T.P. Dronova

16 April 2007

(in millions of Russian Roubles)

	Attributable to the shareholders of OAO Mosenergo				
	Number of shares outstanding (millions)	**Share capital**	**Treasury shares**	**Accumu-lated loss**	**Total**
Balance at 1 January 2005	**28 249**	**154 624**	**(21)**	**(68 987)**	**85 616**
Net loss for the period	-	-	-	(289)	(289)
Total recognized loss for the period	-	-	-	(289)	(289)
Dividends to shareholders	-	-	-	(624)	(624)
Disposal of treasury shares	-	-	21	-	21
Spin-off	-	-	-	(53 733)	(53 733)
Balance at 31 December 2005	**28 249**	**154 624**	-	**(123 633)**	**30 991**
Balance at 1 January 2006	**28 249**	**154 624**	-	**(123 633)**	**30 991**
Net profit for the period	-	-	-	8 596	8 596
Total recognized income for the period	-	-	-	8 596	8 596
Dividends to shareholders	-	-	-	(454)	(454)
Shares issue costs	-	-	-	(19)	(19)
Balance at 31 December 2006	**28 249**	**154 624**	-	**(115 510)**	**39 114**

Chairman of the Management Board A.Y. Kopsov

Chief Accountant T.P. Dronova

16 April 2007

1 Background

(a) OAO Mosenergo and its operations

OAO Mosenergo (OAO Mosenergo or the Group) is a regional utility generating electric power and heat and also providing heat distribution services to the city of Moscow and Moscow region. The Group's asset base includes 17 power stations. The overall operational capacity of OAO Mosenergo is approximately 10 677 megawatts ("MW") of installed generating capacity for electricity and 34 289 gigacalories ("Gkal") of installed generating capacity for heat.

OAO Mosenergo was registered in the Russian Federation on 6 April 1993 in accordance with State Property Management Committee Decree # 169-R dated 26 March 1993. In accordance with the privatisation of the Russian electric utility industry, OAO Mosenergo was organised as a joint stock company.

In 2004 the general shareholders' meeting of OAO Mosenergo approved the entity's restructuring, which entailed the creation of 13 new companies. Before restructuring OAO Mosenergo operated as a vertically integrated utility with primary focus on generation of electricity and heat. Restructuring consisted in spin-off of the following lines of business:

- transmission and distribution of electricity and heat – monopolistic;
- retail sales of electricity, repair and construction – non-core activities;
- four power plants.

As result of the restructuring, in April 2005 each shareholder of OAO Mosenergo received ordinary shares of each of the 13 companies - shares in the companies were distributed among the shareholders of OAO Mosenergo pro rata to OAO Mosenergo shares held by them prior to spin-off. Year ended 31 December 2006 was the first year when OAO Mosenergo worked in new conditions.

As of 20 December 2006 the general shareholders' meeting of OAO Mosenergo approved an increase of share capital of OAO Mosenergo via additional issue of ordinary shares by closed subscription in favour of OAO Gazprom and its affiliates (hereafter - Gazprom Group). After subscription for the new shares Gazprom Group will become the majority shareholder of OAO Mosenergo (see Note 22).

OAO Mosenergo's registered office is located at 8, Raushskaya Naberezhnaya, Moscow, 115035, Russian Federation.

(b) Relations with the state

At 31 December 2006, State-controlled RAO UES of Russia owned 50.9% of the voting ordinary shares of OAO Mosenergo (50.9% at 31 December 2005).

The Group's customer base includes a large number of entities controlled by, or related to the state. Furthermore, the State controls a number of the Group's fuel and other suppliers.

The government of the Russian Federation directly affects the Group's operations through regulation by the Federal service on tariffs ("FST"), with respect to its wholesale energy purchases, and by the Moscow and Moscow Regional Energy Commissions ("REC's"), with respect to its retail electricity and heat sales. The operations of all generating facilities are coordinated by OAO System Operator – Central Despatch Unit of Unified Energy System ("SO-CDU") in order to meet system requirements in an efficient manner. SO-CDU is controlled by RAO UES of Russia.

Tariffs which the Group may charge for sales of electricity and heat are governed by regulations specific to the electricity and heat industry and by regulations applicable to natural monopolies. Historically, such tariffs have been based on a "cost-plus" system, meaning cost of service plus a margin, where costs are determined under the Regulations on Accounting and Reporting of the Russian Federation ("RAR"), a basis of accounting which significantly differs from International Financial Reporting Standards ("IFRS"). In practice, tariff decisions are impacted significantly by social and political considerations, causing significant delays in tariff decisions being received and tariff increases which are lower than required.

As a condition to privatisation in 1992, the government of the Russian Federation imposed an obligation on regional utility companies to provide connections for the supply of electricity and the supply of heating to customers in the Russian Federation. As part of the State's continuing efforts to collect taxes, Governmental Resolution No. 1 was issued on 5 January 1998 and amended on 17 July 1998, which allows the Group to discontinue the supply of electricity and heat to delinquent customers, except for certain governmental and other entities.

As described in Notes 1 (d), the government's economic, social and other policies could have material effects on the operations of the Group.

(c) Regulatory and sector restructuring

The Russian electric utilities industry in general and OAO Mosenergo in particular are presently undergoing a restructuring process designed to introduce competition into the electricity sector and to create an environment in which RAO UES Group and its successor companies (including OAO Mosenergo) can raise the capital required to maintain and expand current capacity.

A crucial step towards the target wholesale electricity (capacity) market model was the adoption of the new Wholesale Electric Power (capacity) Market Rules of the Transitional Period approved by Resolution of the Government of the Russian Federation No. 529 dated August 31, 2006 "On Improvement of the Procedure for Functioning of Wholesale Electric Power (Capacity) Market" which came into force on September 1, 2006. Under the new wholesale market model, the existing electricity and power purchase-and-sale relations in the regulated market sector are to be replaced by a regulated bilateral contract system. From 1 September 2006 regulated contracts covered all volumes of electricity and power produced and consumed.

From 2007 the volumes of electricity (power) traded in the wholesale market at regulated prices will substantially reduce. The pace of reduction will be set annually by the Russian Federation Government according to socio-economic development forecasts. In 2007 up to 95% of the forecasted production volumes will be traded at regulated prices. The period from 2006 to approximately 2013 is a transition period. After that it will become possible to launch a fully competitive wholesale market. The new market model implies two ways of electricity trading at free prices, being free bilateral contracts and a day – ahead market. Under free bilateral contracts market participants have the right to choose contracting parties, prices and supply volumes. The day-ahead market is based on competitive selection of bids submitted by suppliers and buyers a day before the electricity is actually supplied. The competitive selection is performed by the non-commercial partnership "Trade System Administrator of the Wholesale Electricity Market". If there are deviations from the day-ahead forecast, participants are obliged to sell excess amounts or buy missing ones in the balancing market. As a whole, the day-ahead market replaces the free trade sector that was previously operating. Consumption and production planning held by System operator CDU UES is based on the results of bidding.

Operation on the New Wholesale Electric Power (capacity) Market did not have any material impact on these financial statements. Management believes that ultimately a stable regulatory regime and a competitive power market will be put in place such that the Group will be able to raise needed capital to sustain the business. However, there can be no assurance in this regard.

(d) Operating environment

The Russian Federation continues to display some characteristics of an emerging market. These characteristics include, but are not limited to, restrictive currency controls, relatively high inflation, tax, currency and customs legislation within the Russian Federation, which are subject to varying interpretations, and changes, occuring frequently. Whilst there have been improvements in the economic trends, the future economic direction of the Russian Federation is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the government, together with tax, legal, regulatory, and political developments.

(e) Seasonality of business

Demand for both electricity and heat is influenced by both the season of the year and the relative severity of the weather. Revenues from heating are concentrated within the months of October to March. A similar, though less severe, concentration of electricity sales occurs within the same period. The seasonality of electricity and heat production has a corresponding impact on the usage of fuel and the purchase of power.

2 Basis of preparation

(a) Statement of compliance

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") and related interpretations adopted by the International Accounting Standards Board ("IASB"). The accompanying Financial Statements are based on the statutory records and adjusted and reclassified for the purpose of fair presentation in accordance with IFRS.

The consolidated financial statements of the Group are prepared under historical cost convention except as described in Note 3.

(b) Accounting for the effect of hyperinflation

The Russian Federation has previously experienced relatively high levels of inflation and was considered to be hyperinflationary as defined by IAS 29 "Financial Reporting in Hyperinflationary Economies" ("IAS 29"). IAS 29 requires that the financial statements prepared in the currency of a hyperinflationary economy be stated in terms of the measuring unit current at the balance sheet date. Hyperinflation in the Russian Federation ceased effective from 1 January 2003. Restatement procedures of IAS 29 are therefore only applied to assets acquired or revalued and liabilities incurred or assumed prior to that date. For these balances, the amounts expressed in the measuring unit current at 31 December 2002 are treated as the basis for the carrying amounts in these financial statements.

(c) Functional and presentation currency

The national currency of the Russian Federation is the Russian Rouble ("RR"), which is the Company's functional currency and the currency in which these consolidated financial statements are presented. All financial information presented in RR has been rounded to the nearest million.

(d) Going concern

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

(e) New accounting developments

Certain new IFRSs became effective for the Group from 1 January 2006. Listed below are those new or amended standards or interpretations which are or in the future could be relevant to the Group's operations and the nature of their impact on the Group's accounting policies.

- IAS 39 (Amendment) – The Fair Value Option;

- IFRIC 4, Determining whether an Arrangement contains a Lease;
- IAS 39 (Amendment) - Cash Flow Hedge Accounting of Forecast Intragroup Transactions;
- IAS 39 (Amendment) – Financial Guarantee Contracts;
- IAS 21 (Amendment) - Net Investment in a Foreign Operation;
- IAS 19 (Amendment) - Employee Benefits;
- IFRIC 5, Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds;
- IFRIC 6, Liabilities arising from Participating in a Specific Market - Waste Electrical and Electronic Equipment;
- IFRS 6, Exploration for and Evaluation of Mineral Resources (effective from 1 January 2006).

The effect of adoption of the above new or revised standards and interpretations on the Group's financial position at 31 December 2006 and 31 December 2005 and on the results of its operations for the years then ended was not significant.

(f) Other new standards or interpretations

The Group has not early adopted the following other new standards or interpretations:

- IFRS 7 Financial Instruments: Disclosures and a complementary Amendment to IAS 1 Presentation of Financial Statements - Capital Disclosures (effective from 1 January 2007). The IFRS introduces new disclosures to improve the information about financial instruments. The volume of disclosures will increase significantly with an emphasis on quantitative aspects of risk exposures and the methods of risk management. The quantitative disclosures will provide information about the extent to which the entity is exposed to risk, based on information provided internally to the entity's key management personnel. Qualitative and quantitative disclosures will cover exposure to credit risk, liquidity risk and market risk including sensitivity analysis to market risk. IFRS 7 replaces IAS 30, Disclosures in the Financial Statements of Banks and Similar Financial Institutions, and some of the requirements in IAS 32, Financial Instruments: Disclosure and Presentation. The Amendment to IAS 1 introduces disclosures about level of an entity's capital and how it manages capital. The Group is currently assessing what impact the new IFRS and the amendment to IAS 1 will have on disclosures in its financial statements;
- IFRS 8, Operating Segments (effective for annual periods beginning on or after 1 January 2009). The Standard applies to entities whose debt or equity instruments are traded in a public market or that file, or are in the process of filing, their financial statements with a regulatory organisation for the purpose of issuing any class of instruments in a public market. IFRS 8 requires an entity to report financial and descriptive information about its operating segments and specifies how an entity should report such information;
- IFRIC 7, Applying the Restatement Approach under IAS 29 (effective for periods beginning on or after 1 March 2006, that is from 1 January 2007);
- IFRIC 8, Scope of IFRS 2 (effective for periods beginning on or after 1 May 2006, that is from 1 January 2007);
- IFRIC 9, Reassessment of Embedded Derivatives (effective for annual periods beginning on or after 1 June 2006);

- IFRIC 10, Interim Financial Reporting and Impairment (effective for annual periods beginning on or after 1 November 2006);

- IFRIC 11, IFRS 2—Group and Treasury Share Transactions (effective for annual periods beginning on or after 1 March 2007);

- IFRIC 12, Service Concession Arrangements (effective for annual periods beginning on or after 1 January 2008);

- IAS 23, Borrowing Cost (Amendment, aplies to borrowing costs relating to qualifying assets for which the commencement date for capitalization is on or after 1 January 2009). The main change from the previous version is the removal of the option of immediately recognising as an expense borrowing costs that relate to assets that take a substantial period of time to get ready for use or sale.

Unless otherwise described above, these new standards and interpretations are not expected to significantly affect the Group's financial statements.

3 Significant accounting policies

The following significant accounting policies have been applied in the preparation of the consolidated financial statements. The Group has not made changes to its accounting policies in 2006.

(a) Basis of consolidation

(i) Subsidiaries

Subsidiaries are those enterprises controlled by the Group. Control exists when the Group has the power, directly or indirectly, to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control effectively commences until the date that control effectively ceases. The minority interest has been disclosed as part of equity.

(ii) Associates

Associates are those enterprises in which the Group has significant influence, but not control, over the financial and operating policies. The consolidated IFRS financial statements include the Group's share of the total recognised gains and losses of associates on an equity accounted basis, from the date that significant influence effectively commences until the date that significant influence effectively ceases. When the Group's share of losses exceeds the interest in the associate, that interest is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred obligations in respect of the associate.

(iii) Transactions eliminated on consolidation

Intragroup balances and transactions, and any unrealised gains arising from intragroup transactions, are eliminated in preparing the consolidated financial statements. Unrealised gains arising from transactions with associates are eliminated to the extent of the Group's interest in the enterprise. Unrealised gains resulting from transactions with associates are eliminated against the investment in the associate. Unrealised losses are eliminated in the same way as unrealised gains except that they are only eliminated to the extent that there is no evidence of impairment.

(iv) Net assets attributable to minority shareholders

In accordance with Russian legislation, limited liability companies are obliged to pay a withdrawing shareholder its share of the company's net assets. Accordingly, minority interests in limited liability companies are presented as liabilities.

(b) Foreign currencies

Transactions in foreign currencies are translated to RR at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to RR at the foreign exchange rate ruling at that date. Non-monetary assets and liabilities denominated in foreign currencies that are stated at historical cost are translated to RR at the foreign exchange rate ruling at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to RR at the foreign exchange rate ruling at the dates the fair values were determined. Foreign exchange differences arising on translation are recognised in the income statement.

At 31 December 2006 the official rates of exchange, as determined by the Central Bank of the Russian Federation, were:

- RR 26.3311: US Dollar (US$) 1.00 (31 December 2005: RR 28.7825: US$ 1.00);
- RR 34.6965: Euro 1.00 (31 December 2005: RR 34.1850: Euro 1.00).

Exchange restrictions and currency controls exist relating to converting the RR into other currencies. The RR is not freely convertible in most countries outside the Russian Federation.

(c) Property, plant and equipment

(i) Owned assets

Property, plant and equipment are stated at depreciated cost. Deemed cost was initially determined by a third party valuation as at 31 December 1997 and restated for the impact of inflation until 31 December 2002. Adjustments are made for additions, disposals and depreciation charges. At each reporting date management assesses whether there is any indication of impairment of property, plant and equipment. If any such indication exists, management estimates the recoverable amount which is determined as the higher of an asset's fair value less costs to sell and its value in use. The carrying amount is reduced to the recoverable amount and the difference is recognized as an expense (impairment loss) in the income statement. An impairment loss recognized in prior years is reversed if there has been a change in the estimates used to determine an asset's recoverable amount.

The amounts determined by the third party valuation represent an estimate of depreciated replacement cost. The third party valuation was performed in order to determine a basis for cost, because the historical accounting records for property, plant and equipment were not readily available, in accordance with paragraph 16 of IAS 29. Therefore, this third party valuation is not a recurring feature since it was intended to determine the initial cost basis of property, plant and equipment and the Group has not adopted a policy of revaluation on subsequent measurement. The change in carrying value arising from this valuation was recorded directly to retained earnings.

The cost of self constructed assets includes the cost of materials, direct labour and an appropriate proportion of production overheads. Interest on borrowings to finance the construction of property, plant and equipment is capitalized during the period of time that is required to complete and prepare the asset for its intended use. Where an item of property, plant and equipment comprises major components having different useful lives, they are accounted for as separate items of property, plant and equipment.

(ii) Subsequent expenditure

Expenditure incurred to replace a component of an item of property, plant and equipment that is accounted for separately, is capitalised with the carrying amount of the component being written off. Other subsequent expenditure is capitalised if future economic benefits will arise from the expenditure. All other expenditure is recognised in the income statement as an expense as incurred.

(iii) Depreciation

Depreciation is charged to the income statement on a straight-line basis over the estimated useful lives of the individual assets. Depreciation commences on the date of acquisition, or in respect of internally constructed assets, from the time the asset is completed and ready for use. For the property, plant and equipment which was subject to the third party valuation as at 31 December 1997, the depreciation rate applied is based on the estimated remaining useful lives as at the valuation date.

The estimated useful lives are as follows:

- Electricity and heat generation 17 to 50 years;
- Electricity distribution 11 to 25 years;
- Heating networks 14 to 20 years;
- Other 15 years.

(d) Inventories

Inventories are stated at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

The cost of inventories is based on the weighted average cost principle and includes expenditure incurred in acquiring the inventories and bringing them to their existing location and condition.

(e) Accounts receivable and prepayments

Accounts receivable are recorded inclusive of value added taxes which are payable to tax authorities upon collection of such receivables. Trade and other receivables are adjusted for an allowance made for impairment of these receivables. Such an allowance for doubtful debtors is established if there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables. The amount of the allowance is the difference between the carrying amount and the recoverable amount, being the present value of expected cash flows, discounted at the market rate of interest for the similar borrowers at the date of origination of the receivable.

(f) Value added tax

Output value added tax related to sales is payable to tax authorities on the earlier of (a) collection of the receivables from customers or (b) delivery of the goods or services to customers. Input VAT is generally recoverable against output VAT upon receipt of the VAT invoice. The tax authorities permit the settlement of VAT on a net basis. VAT related to sales and purchases is recognised in the balance sheet on a gross basis and disclosed separately as an asset and liability. Where provision has been made for impairment of receivables, impairment loss is recorded for the gross amount of the debtor, including VAT.

(g) Cash and cash equivalents

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

(h) Treasury shares

When share capital recognized as equity is repurchased, the amount of the consideration paid, including directly attributable costs, is deducted from equity. Treasury shares are stated at weighted average cost. Any gains or losses arising on the disposal of treasury shares are recorded directly in equity attributable to the shareholders of OAO Mosenergo.

(i) Dividends

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

(j) Loans and borrowings

Debt is recognized initially at its fair value. Fair value is determined using the prevailing market rate of interest for a similar instrument, if significantly different from the transaction price. In subsequent periods, debt is stated at amortized cost using the effective interest method; any difference between the fair value of the proceeds (net of transaction costs) and the redemption amount is recognized in the income statement as an interest expense over the period of the debt obligation.

(k) Pension and post-employment benefits

In the normal course of business the Group contributes to the Russian Federation state pension scheme on behalf of its employees. Mandatory contributions to the governmental pension scheme are expensed when incurred. Discretionary pensions and other post-employment benefits are included in wages, benefits and payroll taxes in the income statement, however, separate disclosures are not provided as these costs are not material.

(l) Trade and other payables

Accounts payable are stated inclusive of value added tax. Trade payables are accrued when counterparty performed its obligation under the contract and are carried at amortized cost using the effective interest method.

(m) Income tax

Income tax for the period comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly to equity, in which case it is recognised in equity.

Current tax is the amount expected to be paid to or recovered from the taxation authorities in respect of taxable profits or losses for the current and prior periods. Taxes, other than on income, are recorded within operating expenses.

Deferred profit tax is provided using the balance sheet liability method for tax loss carry forwards and temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. In accordance with the initial recognition exemption, deferred taxes are not recorded for temporary differences on initial recognition of an asset or a liability in a transaction other than a business combination if the transaction, when initially recorded, affects neither accounting nor taxable profit. Deferred tax balances are measured at tax rates enacted or substantively enacted at the balance sheet date which are expected to apply to the period when the temporary differences will reverse or the tax loss carry forwards will be utilized. Deferred tax assets and liabilities are netted only within the individual companies of the Group. Deferred tax assets for deductible temporary differences and tax loss carry forwards are recorded only to the extent that it is probable that future taxable profit will be available against which the deductions can be utilized.

(n) Revenues

Revenue is recognized on the delivery of electricity and heat, and on the dispatch of non-utility goods and services. Revenue amounts are presented exclusive of value added taxes.

(o) Segment reporting

The Group operates predominantly in a single geographical area and industry, the generation of electric power and heat in the city of Moscow, Moscow region and the surrounding regions. It is not feasible to identify distinguishable business segments for electric power and heat production. The generation of electricity and heat are related activities and are subject to similar risks and returns, therefore they are reported as one business segment.

(p) Discontinued operations

A discontinued operation is a "component" of the Group's business that represents a separate major line of business or geographical area of operations, or is a subsidiary acquired exclusively with a view to resale. A "component" is a part of the Group that has operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the Group. The operations that were spun off as a result of the Group's restructuring in 2005 (see Note 1a) did not meet the definition of a "component" and therefore are not presented as discontinued operations in these consolidated financial statements.

(q) Earnings per share

The earnings per share is determined by dividing the profit attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the reporting period, excluding the average number of treasury shares held by the Group.

(r) Environmental liabilities

Liabilities for environmental remediation are recorded where there is a present obligation, the payment is probable and reliable estimates exist.

(s) Interest

Interest income and expense are recognized in the income statement for all interest bearing instruments on an accrual basis using effective interest method. Interest income includes nominal interest and accrued discount and premium. When loans become doubtful of collection, they are written down to their recoverable amounts (using the original effective rate) and interest income is thereafter recognised based on the same effective rate of interest.

(t) Fair value disclosure

The fair value of accounts receivable for disclosure purposes is measured by discounting the value of expected cash flows at the market rate of interest for similar borrowers at the reporting date.

The fair value of financial liabilities and other financial instruments (except if publicly quoted) for disclosure purposes is measured by discounting the future contractual cash flows at the current market interest rate available to the Group for similar financial instruments.

The fair value of publicly quoted financial instruments for disclosure purposes are measured based on current market value at the close of business on the reporting date.

(u) Embedded derivatives

The Group enters into purchase agreement for fuel within ordinary course of business. The contracts were entered into and continue to be held for the purpose of receipt or delivery of commodities in accordance with the Group's expected usage requirements and there are not within the scope of IAS 39 but need to be assessed at inception to determine if they contain embedded derivatives.

An embedded derivative is one or more implicit or explicit terms in a contract that affect the cash flows of the contract in a manner similar to a stand-alone derivative instrument. Any embedded derivative that meets the separation criterion should be separated from its host contracts and measured as if it was stand-alone derivative (Fair value through profit or loss) if its economic characteristics are not closely related to those of the host contract.

(aa) Critical accounting estimates and assumptions

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgments are continually evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Management also makes certain judgments, apart from those involving estimations, in the process of applying the accounting policies. Judgments that have the most significant effect on the amounts recognized in the financial statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities within the next financial year include:

(i) Recoverability of property, plant and equipment

One of the most significant judgments and assumptions for OAO Mosenergo relates to recoverability of property, plant and equipment. Main assumptions relate to level and timing of regulatory pricing, which directly affects the cash flow projections (see Note 4).

(ii) Impairment provision for accounts receivable

The impairment provision for accounts receivable is based on the Group's assessment of the collectibility of specific customer accounts. If there is deterioration in a major customer's creditworthiness or actual defaults are higher than the estimates, the actual results could differ from these estimates (see Note 9).

If the Group determines that no objective evidence exists that impairment was incurred for an individually assessed accounts receivable, whether significant or not, it includes the account receivable in a group of accounts receivable with similar credit risk characteristics and collectively assesses them for impairment.

For the purposes of a collective evaluation of impairment accounts receivable are grouped on the basis of similar credit risk characteristics. Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Future cash flows in a group of accounts receivable that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets and the experience of management in respect of the extent to which amounts will become overdue as a result of past loss events and the success of recovery of overdue amounts. Past experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect past periods and to remove the effects of past conditions that do not exist currently.

(iii) Impairment of other assets

At each balance sheet date the Group assesses whether there is any indication that the recoverable amount of the Group's assets has declined below the carrying value. The recoverable amount is the higher of an asset's fair value less costs to sell and its value in use. When such a decline is identified, the carrying amount is reduced to the recoverable amount. The amount of the reduction is recorded in the consolidated income statement in the period in which the reduction is identified. If conditions change and management determines that the assets' value has increased, the impairment provision will be fully or partially reversed. Accounting for impairment includes provisions against property, plant and equipment, investments, other non-current assets and inventory obsolescence.

(iv) Accounting for provisions

The provisions for liabilities and charges primarily include provisions for pension liabilities and legal proceedings. The Group records impairment or accrues these provisions when its assessments indicate that it is probable that a liability has been incurred or an asset will not be recovered and an amount can be reasonably estimated. The Group's estimates for provisions for liabilities and charges are based on currently available facts and the Group's estimates of the ultimate outcome or resolution of the liability in the future.

(in millions of Russian Roubles)

Actual results may differ from the estimates and the Group's estimates can be revised in the future, either negatively or positively, depending upon the outcome or expectations based on the facts surrounding each exposure.

(v) Tax contingencies

Russian tax legislation is subject to varying interpretations and changes, which can occur frequently. Where the Group management believes it is probable that their interpretation of the relevant legislation and the Group's tax positions cannot be sustained, an appropriate amount is accrued for in the IFRS financial information.

(vi) Useful lives of property, plant and equipment

The estimation of the useful life of an item of property, plant and equipment is a matter of management judgment based upon experience with similar assets. In determining the useful life of an asset, management considers the expected usage, estimated technical obsolescence, physical wear and tear and the physical environment in which the asset is operated. Changes in any of these conditions or estimates may result in adjustments for future depreciation rates.

4 Property, plant and equipment

	Electricity and heat generation	Electricity distribution	Heating networks	Construction in progress	Other	Total
Appraised value or cost						
Opening balance as at 01 January 2006	60 298	3 161	4 421	2 182	27 227	97 289
Additions	11	-	-	14 758	65	14 834
Transfers	2 743	724	-	(4 573)	1 106	-
Disposals	(284)	(24)	-	(28)	(238)	(574)
Closing balance as at 31 December 2006	62 768	3 861	4 421	12 339	28 160	111 549
Accumulated depreciation (including impairment)						
Opening balance as at 01 January 2006	(33 613)	(1 427)	(2 693)	-	(21 401)	(59 134)
Charge for the period	(1 595)	(153)	(307)	(20)	(1 737)	(3 812)
Disposals	283	24	-	-	237	544
Reversal of impairment	8 312	569	483	-	1 168	10 532
Closing balance as at 31 December 2006	(26 613)	(987)	(2 517)	(20)	(21 733)	(51 870)
Net book value as at 01 January 2006	26 685	1 734	1 728	2 182	5 826	38 155
Net book value as at 31 December 2006	36 155	2 874	1 904	12 319	6 427	59 679

(in millions of Russian Roubles)

	Electricity and heat generation	Electricity distribution	Heating networks	Construction in progress	Other	Total
Appraised value or cost						
Opening balance as at 01 January 2005	91 499	49 411	23 537	5 345	42 797	212 589
Additions	14	9	-	4 852	48	4 923
Transfers	369	351	114	(1 682)	848	-
Disposals	(247)	(74)	(127)	(56)	(558)	(1 062)
Spin-off	(31 337)	(46 536)	(19 103)	(6 277)	(15 908)	(119 161)
Closing balance as at 31 December 2005	60 298	3 161	4 421	2 182	27 227	97 289
Accumulated depreciation (including impairment)						
Opening balance as at 01 January 2005	(48 445)	(22 227)	(12 815)	-	(31 943)	(115 440)
Charge for the period	(2 158)	(693)	(622)	-	(2 139)	(5 612)
Disposals	146	43	75	-	535	799
Spin off	16 854	21 450	10 669	-	12 146	61 119
Closing balance as at 31 December 2005	(33 613)	(1 427)	(2 693)	-	(21 401)	(59 134)
Net book value as at 01 January 2005	43 044	27 184	10 722	5 345	10 854	97 149
Net book value as at 31 December 2005	26 685	1 734	1 728	2 182	5 826	38 155

Included in additions above is capitalized interest of RR 591 and nil for the years ended 31 December 2006 and 2005, respectively. Capitalization rate of 8.51% was used representing the weight average actual borrowing cost of the relevant borrowings for the year ended 31 December 2006.

Construction in progress includes advances to construction companies and suppliers of property, plant and equipment of RR 5 042 (net of VAT) and RR nil as of 31 December 2006 and 2005 respectively.

Other property, plant and equipment are comprised of motor vehicles, computer equipment, office fixtures and other assets not included in categories mentioned above.

Included in additions are non-cash additions of RR nil and RR 1 032 for the years ended 31 December 2006 and 2005, respectively.

(a) Reversal of impairment provision for property, plant and equipment

As at 31 December 2006, the Group assessed whether there is any indication that an impairment loss recognized in prior periods for property, plant and equipment may no longer exist.

Management concluded that at the reporting date there were indications for reversing previously recognized impairment losses based on significant changes with a favorable effect on the Group that have occurred or are expected to occur in the near future in the market and economic environment in which the Group operates.

Key positive developments include:

1. higher expected growth of demand for electricity and heat in the region in which the Group operates, which is based on recent trends;
2. higher certainty about the free trading sector for electricity, which has been enacted by the government of the Russian Federation as of August 2006 (see Note 1);

(in millions of Russian Roubles)

In addition, preliminary results of an independent appraisal available at the date of signing of these financial statements indicate, that the fair value of the Group's property, plant and equipment will be significantly higher than its net book value as of 31 December 2006, including the effect of reversal of impairment provision (see Note 22). Appraisers used a depreciated replacement cost approach, which resulted in values even higher than the fair value of Group's property, plant and equipment.

These developments have resulted in a change to the assumptions that were used to determine the value in use of the assets and a reversal of the previously recognized impairment loss in the amount of RR 10 532 at 31 December 2005. A respective gain together with a corresponding deferred tax expense of RR 2 528 were recognized in the income statement for the year ended 31 December 2006.

The key assumptions used to determine the value in use of the property, plant and equipment were as follows:

1. Electricity tariffs in regulated sector will be increased by 25%, 24.5%, 24.1% for the years ended 31 December 2008, 2009 and 2010, respectively; gross rate is zero starting 2011 year;
2. Heat tariffs will be increased by 19.8%, 20% and 17.6% for the years ended 31 December 2008, 2009 and 2010, respectively; gross rate is zero starting 2011 year;
3. Gas price will be increased by 25%, 27.7% and 27.7% for the years ended 31 December 2008, 2009 and 2010, respectively; gross rate is zero starting 2011 year;
4. Growth of gas prices and other operating costs will be accounted for by the Regional Tariff Service in the course of establishing regulated electricity and heat tariffs on a "cost-plus" basis;
5. Inflation rate will not exceed 7 per cent per year;
6. Increase of major variable cost (except for fuel) will not be higher, then inflation rate;
7. Pre-tax discount rate used to determine assets value in use is equal to 12.5 %.

Gas price, heat tariffs and electricity tariffs (in regulated sector) approved by respective regulators for 2007 year indicates increase by 15%, 12.5% and 13% respectively in comparison with year ended 31 December 2006.

Management assessment indicates, that value in use will not be lower than PPE net book value including effect of reversal of impairment provision (i.e. will not be lower, than RR 47 360), provided that increase of electricity tariffs in regulated sector for the years ended 31 December 2008, 2009 and 2010 will not be lower, than 22 % per year.

(b) Operating lease

The Group leases a number of land areas owned by local governments under operating lease. Land lease payments are determined by lease agreements.

Operating lease rentals are payable as follows:

	31 December 2006
Less than one year	263
Between one and five years	1 103
More than five years	11 293
	12 659

The land areas leased by the Group are the territories on which the Group's electric power stations, heating stations and other assets are located. The leases typically run for an initial period of 5 to 45 years with an option to renew the lease after that date. Leased payments are reviewed regularly to reflect market rentals.

(in millions of Russian Roubles)

5 Investments in associates

The Group has the following investments in associated undertakings:

	Country	Ownership/Voting
OOO KB Transinvestbank	Russia	24.61%

The table below summarise the movements in the carrying amount of the Group's investment in an associated undertaking:

	31 December 2006	31 December 2005
Carrying amount at 1 January	328	-
Recognition of associate share in net assets	-	249
Share of after tax result of associated undertaking	42	79
Dividends received from associated undertaking	(24)	-
Carrying amount at 31 December	**346**	**328**

At 31 December 2006 and 31 December 2005 summarized financial information of associated undertaking, including total assets, liabilities, revenues and profit were as follows:

	31 December 2006	31 December 2005
Assets	3 829	5 403
Liabilities	(2 423)	(4 069)
Total equity	1 406	1 334

	For the year ended 31 December 2006	For the year ended 31 December 2005
Revenues	770	1 284
Expenses	(601)	(856)
Net profit	**169**	**428**

6 Other non-current assets

Other non-current assets are represented by the following:

	31 December 2006	31 December 2005
Long-term trade receivables (net of provision of nil as at 31 December 2006 and of nil as at 31 December 2005)	71	55
Advances to lessors and suppliers	135	17
Available-for-sale investments	9	10
	215	**82**

(in millions of Russian Roubles)

7 Inventories

	31 December 2006	31 December 2005
Fuel production stocks	2 998	1 945
Materials and supplies	1 322	951
Other inventories	26	70
	4 346	**2 966**

Materials and supplies are shown net of a provision for obsolete inventory and an adjustment for slow-moving inventory of RR 17 as at 31 December 2006 and RR 129 as at 31 December 2005.

8 Other current assets

	31 December 2006	31 December 2005
Assets constructed under financing from Moscow Government (see Note 15)	523	523
Other current assets	143	156
	666	**679**

9 Accounts receivable and prepayments

	31 December 2006	31 December 2005
Trade receivables (Net of provision for impairment of receivables of RR 1 161 as at 31 December 2006 and RR 1 316 as at 31 December 2005)	2 066	3 826
Value Added Tax recoverable	1 492	1 007
Advances to suppliers and prepayments	500	521
Tax prepayments (other than current profit tax prepayments)	76	384
Receivables from associate	-	23
Other receivables (Net of provision for impairment of receivables of RR 255 as at 31 December 2006 and RR 350 as at 31 December 2005)	787	189
	4 921	**5 950**

Management has determined the allowance for doubtful debtors based on specific customer identification, customer payment trends, subsequent receipts and settlements and analyses of expected future cash flows. The management of the Group believes that the Group will be able to realize the net receivable amount through direct collections and other non-cash settlements, and because of their short term nature, therefore the recorded value approximates their fair value.

(in millions of Russian Roubles)

10 Cash and cash equivalents

	31 December 2006	31 December 2005
Cash at bank and in hand	5 720	2 373
Foreign currency bank accounts	9	10
Cash and cash equivalents	**5 729**	**2 383**

Cash and cash equivalents balances do not include balances on special accounts in OAO ABN AMRO bank and OAO KB Citibank in the aggregate amounts of RR 143 and RR 156 as at 31 December 2006 and 31 December 2005 respectively. Such balances are allotted for the purpose of repayment of principal amount of a debt and interest on EBRD and IFC loans. Such balances are classified within other current assets.

11 Equity

(a) Share capital

Number of shares unless otherwise stated	**Ordinary shares**	
	31 December 2006	**31 December 2005**
Authorised shares	28 249 359 700	28 249 359 700
Par value	RR 1.00	RR 1.00

As of 31 December 2006 and 31 December 2005 all shares have been issued and fully paid.

The carrying amount of share capital has been adjusted to take into account the effects of hyperinflation that existed in Russian Federation until the end of 2002.

(b) Treasury shares

OAO Mosenergo has made no operations with its own shares. It had no treasury shares as at 31 December 2006.

(c) Dividends

A decision in respect of the payment of dividends following OAO Mosenergo’s 2005 results was taken on 26 May 2006. The amount of declared (accrued) dividends on the issuer’s shares was RR 0.016 per share, total amount of dividends is RR 454.

In accordance with Russian legislation, the OAO Mocenergo distributes profits as dividends or transfers them to reserves (fund accounts) on the basis of financial statements prepared in accordance with Russian Accounting Rules. The statutory accounting reports of the Company are the basis for profit distribution and other appropriations. Russian legislation identifies the basis of distribution as the net profit. For the year ended 31 December 2006, the current year net statutory profit for the OAO Mocenergo as reported in the published annual statutory reporting forms was RR 1 523 (for the year ended 31 December 2006 - RR 2 081) and the closing balance of the accumulated profit including the current year net statutory profit totalled RR 1 924 (as of 31 December 2005 - RR 950). However, this legislation and other statutory laws and regulations are open to legal interpretation and accordingly management believes at present it would not be appropriate to disclose an amount for the distributable reserves in these financial statements**.**

(in millions of Russian Roubles)

12 Loans and borrowings

	Currency	Effective Interest rate	31 December 2006	31 December 2005
Non-current				
Secured bank loans				
IFC	USD	LIBOR+3.5%	118	-
EBRD	USD	LIBOR+3.5%	178	-
EBRD	RR	MosPrime+4%, MosPrime++2.75%	7 200	-
Unsecured bank loans				
Vneshtorgbank	RR	8,50%	2 787	-
Unsecured bonds				
Unsecured bond issue #1	RR	7,54%	5 000	-
Unsecured bond issue #2	RR	7,65%	5 000	-
Other LT borrowings	RR		155	-
Total			**20 438**	**-**
Current				
Unsecured bank loans				
Gazprombank	RR	9.5%	-	6 350
Secured bank loans				
Russian Commercial Bank	RR	10,00%	-	600
Eurofinance	RR	11,75%	-	1 300
IFC	USD	LIBOR+3.5%	59	366
EBRD	USD	LIBOR+3.5%	89	291
EBRD	USD	LIBOR+4%	432	907
Total			**580**	**9 814**
			21 018	**9 814**

The effective interest rate is the market interest rate applicable to the loan at the date of origination for fixed rate loan and the current market rate for floating rate loans.

Borrowings include fixed rate loans with a carrying value of RR 12 942 and RR 8 250 and fair value of RR 12 949 and RR 8 245 as of 31 December 2006 and 2005, respectively. All other borrowings generally have variable interest rates linked to LIBOR or MosPrime, and the carrying amounts approximates fair value.

The Group has not entered into any hedging arrangements in respect of its foreign currency obligation or interest rate exposure.

(a) EBRD and IFC loans

These loans were obtained in April 1998 to finance capital expenditure. Loans from EBRD and IFC were received under non-revolving line of credit agreements (loan amount not to exceed USD 50 million in total). The full amount available under the agreements had been provided to the Group by 31 March 2001. The Group is required to make 18 principal payments on a semi-annual basis, beginning 15 January 2001. Interest is payable at the same time as the principal.

In August 2002 OAO Mosenergo obtained a loan from EBRD under a non-revolving line of credit for the amount of USD 70 million. OAO Mosenergo is required to make 10 principal payments semi-annually, beginning 28 May 2003. Interest is payable at the same time as the principal.

(in millions of Russian Roubles)

On 23 December 2005 the Group concluded the agreement with EBRR to open a credit line in the total amount of RR 7 200 for more than 10 years. The credit line consisted of two credit lines in amounts of RR 2 900 and RR 4 300 respectively. The loan was obtained for the purchase of acquiring additional equipment for the Group. The loan interest on loans is determined on Mosprime plus basis.

The payment of interest on the loan is carried out on a quarterly basis, and the principal amount is to be repaid by 40 and 18 equal installments for the first and second credit lines respectively starting after 31 December 2007.

Net book value of fixed assets pledged as security for loans was RR 679 and RR 554 as of 31 December 2006 and 31 December 2005.

(b) Unsecured bonds

On 2 March 2006 the placement of OAO Mosenergo's 5 000 000 unconvertible fixed interest rate bearing bonds took place through underwriter Gazprombank on the trading floor of Moscow Interbank Currency Exchange. The total amount of placement equaled RR 5 billion. The face value of each bond is RR 1 000, term of maturity of ten years. Interest of 7.65% will be paid to the bond holders semiannually.

The bonds may become subject for early redemption only upon the decision of the issuer to grant such option to the bond holders. The main purpose of bond issues is to refinance short-term bank loans.

On 19 September 2006 OAO Mosenergo registered the second issue of 5,000,000 fixed interest rate bearing bonds with the face value of RR 1,000 and term of maturity of five years. The total amount of placement equaled RR 5 billion. Interest of 7.54% will be paid to the bond holders semiannually.

(c) Borrowings maturity

As of 31 December 2005 OAO Mosenergo did not comply with liquidity requirements as stated in loan agreements with the EBRD and IFC. These breaches give the EBRD and IFC the right to demand immediate repayment of the loans. Therefore, in accordance with IAS 32, these loans were reclassified to current debt at the balance sheet date. OAO Mosenergo's liquidity has been improved following the issuance of bonds in April 2006 and subsequently in September 2006 and no liquidity breaches exist as of the date of issuing these Financial Statements.

As of 31 December 2006 the maturity portfolio of long-term borrowings is presented below:

	31 December 2006
Between one and two years	3 238
Between two and five years	5 000
After five years	12 200
	20 438

(in millions of Russian Roubles)

13 Profit tax

(a) Profit tax expense

The Group's applicable tax rate is the corporate income tax rate of 24% (2005: 24%).

	Period ended 31 December 2006	Period ended 31 December 2005
Current profit tax charge	(1 798)	(1 032)
Deferred profit tax (charge) /benefit	(2 298)	207
Origination and reversal of temporary differences	**(4 096)**	**(825)**

As of 31 December 2006 Federal Tax Authority declared decision concerning tax inspection for 2002 and 2003 years. In accordance with decision OAO Mosenergo was exposed to additional income tax at the total amount of RR 576, which has been accrued for in these consolidated financial statements.

Profit before tax for the financial reporting purposes is reconciled to the profit tax as follows:

	Period ended 31 December 2006	Period ended 31 December 2005
Profit before tax	**12 692**	**566**
Profit tax expense/ (benefit) at applicable tax rate (24 %)	(3 046)	(136)
Non-deductible/non-taxable items	(1 050)	(614)
Other effects	-	(75)
	(4 096)	**(825)**

(b) Deferred profit tax

(i) Recognised deferred tax assets and liabilities

Difference between IFRS and Russian statutory taxation regulations give rise to certain temporary differences between the carrying value of certain assets and liabilities for financial reporting purposes and for profit tax purposes. Deferred profit tax assets and liabilities are measured at 24 percent, the rate applicable when the asset or liability will reverse.

(ii) Movement in temporary differences during the period

	31 December 2005	Differences recognition and reversal	31 December 2006
Property, plant and equipment	(4 425)	(2 343)	(6 768)
Trade and other receivables	62	111	173
Other	370	(66)	304
	(3 993)	**(2 298)**	**(6 291)**

14 Earnings per share

The calculation of earnings per share is the net profit for the year period divided by the weighted average number of ordinary shares outstanding during the period, calculated as shown below. OAO Mosenergo does not have dilutive potential ordinary shares.

In thousands of shares	**Year ended 31 December 2006**	**Year ended 31 December 2005**
Weighted average number of ordinary shares outstanding	28 249 360	28 249 360
Adjustment for weighted average number of treasury shares	-	(1 301)
Weighted average number of ordinary shares at 31 December 2006	28 249 360	28 248 059
Net profit/ (loss) attributable to the shareholders of OAO Mosenergo for the year, RR	**8 596**	**(289)**
Weighted average profit/loss per ordinary share – basic and diluted, Russian Rouble	0.30	(0.01)

15 Accounts payable and accrued charges

	31 December 2006	**31 December 2005**
Trade payables	2 581	1 696
Account payable for acquisition of property, plant and equipment	1 987	812
Accrued liabilities and other creditors	1 618	1 646
Advances received	1 028	366
Financing from Moscow Government	523	523
	7 737	**5 043**

Financing from the Moscow government relates to the funds received by the Group, on a return basis, as a contribution by the Moscow government towards the construction of distribution and heating network assets. Repayment terms stipulated that certain assets (as provided by further agreements), upon their completion, will be transferred to the Moscow government in the settlement of the above liability.

16 Other taxes payable

	31 December 2006	**31 December 2005**
VAT payable	527	1 404
Property tax	174	192
Employee taxes payable	203	183
Other taxes payable	171	89
	1 075	**1 868**

(in millions of Russian Roubles)

17 Financial expenses

	Period ended 31 December 2006	Period ended 31 December 2005
Interest expense	526	1 066
Interest income	(63)	-
Foreign exchange (gain)/loss	(100)	59
	363	**1 125**

18 Financial Risk Management

(a) Credit risk

Financial assets which potentially subject Group entities to concentrations of credit risk consist principally of trade receivables including promissory notes. Credit risks related to trade receivables are systematically monitored and are considered when the allowance for doubtful debtors is made. The carrying amount of trade receivables, net of the allowance for doubtful debtors, represents the maximum amount exposed to credit risk. Although collection of receivables could be influenced by economic factors, management believes that there is no significant risk of loss to the Group other than to the extent to which provision for impairment of receivables has already been made.

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

(b) Interest rate risk

Changes in interest rates impact primarily loans and borrowings by changing either their fair value (fixed rate debt) or their future cash flows (variable rate debt). The largest part of interest rate in long-term borrowings are fixed, which expose the Group to fair value interest rate risk.

Currently the Group does not operate a formal management program focusing on the unpredictability of financial markets or seeking to minimize potential adverse effects on the financial performance of the Group. However, at the time of taking new borrowings management uses its judgment to decide whether it believes that a fixed or variable rate would be more favourable to the Group over the expected period until maturity.

(c) Foreign currency risk

The Group operates within the Russian Federation. The majority of the Group's purchases are denominated in RR. The major concentration of foreign exchange risk is in relation to foreign currency denominated purchase commitments (see Note 19) and foreign currency denominated debt (see Note 12). Management does not hedge the Group's exposure to foreign currency risk.

(d) Fair values

The fair value of borrowings is discussed in Note 12. Management believes that the fair value of other financial assets and financial liabilities is not significantly different from their carrying amounts.

Exposure to credit, interest rate and currency risk arises in the normal course of the Group's business. The Group does not have a risk policy to hedge its financial exposures.

19 Commitments

(a) Fuel commitments

The Group has a number of outstanding fuel contracts. Gas supplies are mostly received from OOO Mosregiongas, a subsidiary of OAO Gazprom. The gas is supplied under annual agreement, which is effective till 31 December 2007. The quantity of gas to be supplied is determined based on the budgeted production requirements. The purchase price of the contract is fixed at the level determined by Government (Federal Energy Commission).

(b) Social commitments

The Group contributes to the maintenance and upkeep of the local infrastructure and the welfare of its employees, including contributions toward the construction, development and maintenance of housing, hospitals, recreation and other social needs in the geographical areas in which it operates.

(c) Capital commitments

Future capital expenditure for which contracts have been signed amounted to RR 21 921 million at 31 December 2006 (RR 1 016 as of 31 December 2005). RR 5 722 of capital commitments as of 31 December 2006 are denominated in foreign currencies, mainly Euro and Swiss francs.

20 Contingencies

(a) Tax legislation

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 Group may be challenged by the relevant regional and federal authorities. Recent events within the Russian Federation suggest that the tax authorities may be taking a more assertive position in their interpretation of the legislation and assessments, and it is possible that transactions and activities that have not been challenged in the past may be challenged. As a result, 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.

The Group's Management believes that its interpretation of the relevant legislation is appropriate and the Group's tax, currency legislation and customs positions will be sustained.

(b) Legal proceedings

The Group is a party to certain legal proceedings arising in the ordinary course of business. In general those legal proceedings relate to unreasonable application of tariffs. In the opinion of management, there are no current legal proceedings or other claims outstanding that, upon final disposition, will have a material adverse effect on the financial position of the Group.

As of the date of issuing these consolidated financial statements management believes that it has adequately provided for all significant potential losses that may result from any such claims being asserted and contested.

(c) Compliance with covenants.

The Group is subject to certain covenants related primarily to its borrowings. Non-compliance with such covenants may result in negative consequences for the Group including growth in the cost of borrowings and declaration of default. The Group's Management believes that the Group is in compliance with covenants.

(in millions of Russian Roubles)

(d) Environmental matters.

The enforcement of environmental regulation in the Russian Federation is evolving and the enforcement posture of government authorities is continually being reconsidered. The Group periodically evaluates its obligations under environmental regulations. As obligations are determined, they are recognized immediately. Potential liabilities, which might arise as a result of changes in existing regulations, civil litigation or legislation, cannot be estimated but could be material. In the current enforcement climate under existing legislation, management believes that there are no significant liabilities for environmental damage.

(e) Guarantees

The Group issued guarantees for mortgage loans of employees of RR 212 as of 31 December 2006 (RR 8 as of 31 December 2005).

21 Related parties

For the purposed of these financial statements, parties are considered to be related if one party has the ability to control the other party, is under common control, or can exercise significant influence over the other party in making financial and operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

The nature of the related party relationships for these related parties with whom the Group entered into significant transactions or had significant balances outstanding for the year ended and as of 31 December 2006 and 2005 are detailed below.

(a) Parent company

RAO UES of Russia owns 50.9% of the ordinary voting shares of OAO Mosenergo and has effective control over the Group's operations.

The Russian Government is the ultimate controlling party of the Group, owning 52.68 % of RAO UES of Russia.

During the years ended 31 December 2006 and 31 December 2005 Group paid dividends to RAO UES of Russia in the amount of RR 231and RR 318, respectively.

During the year ended 31 December 2005 RAO UES of Russia charged the Group a fee for services on organisation performance and development of Unified Energy System of Russia in the amount of RR 723 (nil for the year ended 31 December 2006) and the Group redeemed the loan from RAO UES of Russia in the amount of RR 646.

(b) Subsidiaries and associates of RAO UES of Russia

For the year ended and as of 31 December 2006 and 2005, respectively, the Group had the following significant transactions and balances with subsidiaries and associates of RAO UES of Russia :

	Year ended 31 December 2006	Year ended 31 December 2005
Revenue		
Electricity	26 229	20 158
Heat	1 203	719
Lease income	806	553
Other revenue	1 093	1 191
	29 331	**22 621**

(in millions of Russian Roubles)

	Year ended 31 December 2006	Year ended 31 December 2005
Purchases		
Purchased power	-	3 301
Transmission fee	11 358	5 433
Subscribtion fee	557	881
Other purchases	25	23
	11 940	**9 623**

	31 December 2006	31 December 2005
Accounts receivable		
Trade accounts receivable	866	1 334
Other accounts receivable	285	75
Advances issued (Power Machines)	2 213	47
	3 364	**1 456**
Accounts payable		
Trade accounts payable	1 041	199
Other accounts payable	97	48
Advances received	32	2
	1 170	**249**

During the year ended 31 December 2006 the Group purchased equipment from Power Machines on the amount of RR 1 132.

(c) Transactions with associated undertaking (OOO KB Transinvestbank)

Included within short-term account receivable and prepayments are account receivable from associated undertaking (OOO KB Transinvestbank) in the amount RR nil and RR 23 as of 31 December 2006 and 2005, respectively.

During the years ended 31 December 2006 and 31 December 2005 the Group provided rent services to OOO KB Transinvestbank for RR 20 and RR 46, respectively.

During the years ended 31 December 2006 and 31 December 2005 the Group received bank services form OOO KB Transinvestbank for RR 141 and RR 641 respectively.

Included in cash and cash equivalents of the Group are cash accounts with OOO KB Transinvestbank of RR 587 and RR 1 480 as of 31 December 2006 and 31 December 2006, respectively.

(d) Compensation for key management personnel

Key management personnel (the members of the Board of Directors and Management Committee of OAO Mosenergo) short-term compensation, including salary and bonuses, amounted to RR 103 and RR 167 for the year ended 31 December 2006 and 31 December 2005, respectively. Such amounts include personal income tax and are net of unified social tax. The remuneration for serving on the Board of Directors is subject to approval by the General Meeting of Shareholders, compensation of key management personnel (other then remuneration for serving as members of Board of Directors) is determined by the terms of the employment contracts.

(e) OAO Gazprom and its subsidiaries (Gazprom Group)

Gazprom Group have significant influence over the OAO Mosenergo. The Government of the Russian Federation is the ultimate controlling party of OAO Gazprom and has controlling interest (including both direct and indirect ownership) of over 50% in OAO Gazprom.

(in millions of Russian Roubles)

For the year ended and as of 31 December 2006 and 2005, respectively, the Group had the following significant transactions and balances with Gazprom Group:

	Year ended 31 December 2006	Year ended 31 December 2005
Revenue	189	33
Fuel expenses	(29 286)	(25 974)
Interest expenses	(204)	(132)
Proceeds from borrowings	12 695	6 406
Repayment of borrowings	19 046	55

	31 December 2006	31 December 2005
Deposits	900	-
Accounts Payable	501	405
Advances given	110	-
Loans and borrowings	-	6 351

During the year ended 31 December 2006 OAO Mosenergo placed and withdrew cash on short-term deposit in AB Gazpormbank (ZAO) for RR 4 200 and RR 3 300, respectively.

Included in cash and cash equivalents of the Group are cash accounts with AB Gazpormbank (ZAO) of RR 1 447 and RR 66 as of 31 December 2006 and 31 December 2005, respectively.

(f) Parties under control of the Government

Information provided below exclude transactions and balances with RAO UES Russia, its subsidiaries and associates, OAO Gazprom and its subsidiaries, that are disclosed in Notes 24 (a), (b) and (e) above.

In the normal course of business the Group enters into transactions with other entities under Government control.

Bank loans are provided on the basis of market rates. Taxes are accrued and settled in accordance with Russian tax legislation. Tax balances are disclosed in Note 14. Tax transactions are disclosed in the income statement.

For the year ended and as of 31 December 2006 and 2005, respectively, the Group had the following significant transactions and balances with Government and parties under control of the Government:

	Year ended 31 December 2006	Year ended 31 December 2005
Revenue from heat sales	22 646	19 983
Fuel expenses	(1 985)	(1 623)
Water usage expenses	(342)	(436)
Purchased heat	(305)	(284)
Security costs	(211)	(69)
Interest expense	(94)	(355)
Other expenses	(287)	(297)
Proceeds from borrowings	11 787	21 000
Repayment of borrowings	9 000	27 600

	31 December 2006	31 December 2005
Cash	2 404	508
Accounts Receivable (net of provision for impairment of receivables of RR 843 As at 31 December 2006 and RR 804 as at 31 December 2005)	450	466
Accounts Payable	219	163
Borrowings	2 787	-

22 Events subsequent to the balance sheet date

(a) Issue of ordinary shares

As of 20 December 2006 the shareholders' meeting of OAO Mosenergo approved increase of share capital of OAO Mosenergo via additional issue of 11 500 million of ordinary shares with nominal value equal to 1 RR per share by closed subscription in favour of OAO Gazprom and its affiliates. Offering price was approved at RR 5.28 per share (determined based on quoted price of OAO Mosenergo shares during the period of 19 June 2006 – 19 December 2006).

Payment for shares by OAO Gazprom and its affiliates should take place from 12 April 2007 till 26 April 2007 (the period of privileged subscription for additional shares by existing shareholders took place from 15 February 2007 to 2 April 2007).

After subscription for new shares Gazprom Group will become the majority shareholder of OAO Mosenergo. Cash generated from issuance of additional shares will be used for financing of capital expenditure.

(b) Revaluation of property, plant and equipment

Management decided to change in accounting policy in respect of Property, Plant and equipment from the cost model to the revaluation model in order to achieve fair presentation of the Group's financial position.

A revaluation is being conducted in 2007 by a consortium of appraisers consisting of Ernst and Young Limited, International Appraisal Centre and NP Consult within the framework of agency contract with RAO UES of Russia.

Preliminary results of the independent revaluation available at the date of signing of these financial statements indicates that the fair value of the Group's property, plant and equipment will be significantly higher than the net book value as of 31 December 2006. The application of the change in the accounting policy will be prospective from 1 January 2007 in accordance with the provisions in the relevant standards.

(c) Pension benefits

As of 29 January 2007 Board of Directors of OAO Mosenergo approved the Non-State Pension Program for the employees (defined benefit pension plan), that will be executed with Non-State Pension Fund of Electric power Industry (subsidiary of RAO UES of Russia) and Non-State Pension Fund Gazfund (subsidiary of OAO Gazprom), contracts with these non-state pension funds were signed in 2007.

The defined benefit plan arranges pension benefits that an employee will receive on retirement, level of benefits will depends on number of factors such as age, years of service and level of remuneration. No liability was recognized in these consolidated financial statements as there were no constructive obligation as of 31 December 2006. The Group has not yet completed its analysis of the impact of new pension program.

(d) Dividends for 2006 year

The Board of Directors of OAO Mosenergo proposed a dividend of 0.02124 Russian Roubles per share on 26 March 2007. The total amount of dividends proposed is RR 600. The proposed dividend will be approved by the OAO Mosenergo shareholders meeting in May 2007.