OPEN JOINT STOCK COMPANY MOSENERGO

IFRS CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2003

PRICEWATERHOUSECOOPERS

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AUDITORS' REPORT

To the Shareholders and the Board of Directors of the Open Joint Stock Company for Energy and Electrification Mosenergo ("JSC Mosenergo")

1. We have audited the accompanying consolidated balance sheet of JSC Mosenergo and its subsidiaries (the “Group”) as at 31 December 2003, the related consolidated income statement for the year then ended, and the related consolidated statements of cash flows and of changes in shareholders’ equity for year then ended. These consolidated financial statements, set out on pages 1 through 23, are the responsibility of the Group's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

2. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

3. In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2003, and the results of its operations, and its cash flows for the year then ended, in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers

Moscow, Russian Federation

30 March 2004

JSC Mosenergo

Consolidated Balance Sheet as at 31 December 2003

(in millions of Russian Roubles)

	Notes	31 December 2003	31 December 2002
Assets			
Non-current assets			
Property, plant and equipment	8	94,295	95,051
Other non-current assets	9	3,546	628
Total non-current assets		**97,841**	**95,679**
Current assets			
Inventories	10	4,372	3,362
Accounts receivable and prepayments	11	8,711	9,017
Other current assets		2,091	546
Cash	12	3,543	1,663
Total current assets		**18,717**	**14,588**
Total assets		**116,558**	**110,267**
Shareholders' equity and liabilities			
Shareholders' equity			
Share capital			
Ordinary shares (nominal value RR 28 268 million)	13	154,720	154,720
Treasury shares		(9)	(14)
		154,711	154,706
Accumulated deficit		(70,139)	(70,357)
Total shareholders' equity		**84,572**	**84,349**
Minority interest		177	79
Non-current liabilities			
Non-current debt	14	2,726	3,901
Deferred income tax	16	9,258	10,476
Other non-current liabilities		-	112
Total non-current liabilities		**11,984**	**14,489**
Current liabilities			
Current debt and current portion of non-current debt	15	9,212	3,152
Accounts payable and accrued charges	17	7,702	5,936
Taxes payable	18	2,911	2,262
Total current liabilities		**19,825**	**11,350**
Total liabilities		**31,809**	**25,839**
Total equity and liabilities		**116,558**	**110,267**

General Director — Evstafiev A.V.

Chief Accountant — Dronova T.P.

30 March 2004

JSC Mosenergo
Consolidated Income Statement for the year ended 31 December 2003

(in millions of Russian Roubles)

	Notes	Year ended 31 December 2003	Year ended 31 December 2002
Revenues			
Electricity		47,130	37,685
Heating		19,953	16,742
Other		2,411	1,869
Total revenues		**69,494**	**56,296**
Operating expenses			
Fuel expenses		23,660	18,338
Wages and payroll taxes		10,920	9,370
Depreciation	8	8,822	8,191
Repairs and maintenance		8,189	6,436
Transmission fees		5,531	4,608
Taxes other than on income		2,315	2,354
Other materials		1,398	1,211
Insurance costs		1,187	662
Purchased power		986	835
Social expenditures		621	578
Increase / (release) of provision for impairment of receivables		598	(759)
Water usage expenses		450	369
(Gain) / loss on disposal of fixed assets		(859)	506
Other expenses		4,228	3,298
Total operating expenses		**68,046**	**55,997**
Income from operations		**1,448**	**299**
Monetary effects and financing items	19	(655)	(679)
Income / (loss) before income tax and minority interest		**793**	**(380)**
Total income tax benefit / (charge)	16	42	(1,941)
Income / (loss) before minority interest		**835**	**(2,321)**
Minority interest: share of net result		(98)	(20)
Net income / (loss)		**737**	**(2,341)**
Income / (loss) per share - basic and diluted - in Russian Roubles:	20	0.03	(0.08)

General Director Evstafiev A.V.

Chief Accountant Dronova T.P.

30 March 2004

JSC Mosenergo
Consolidated Statement of Cash Flows for the year ended 31 December 2003
(in millions of Russian Roubles)

	Notes	Year ended 31 December 2003	Year ended 31 December 2002
CASH FLOW FROM OPERATING ACTIVITIES			
Income / (loss) before income tax and minority interest		**793**	**(380)**
Adjustments to reconcile income / (loss) before income tax and minority interest to net cash provided by operations:			
Depreciation		8,822	8,191
Increase / (release) of provision for impairment of receivables		598	(759)
Interest expense	19	885	917
(Gain) / loss on disposals of fixed assets		(859)	506
Monetary effects and foreign exchange differences	19	(230)	(619)
Adjustment for non-cash investing activities	8	657	(137)
Other		-	17
Operating cash flow before working capital changes		**10,666**	**7,736**
Working capital changes:			
(Increase) / decrease in accounts receivable and prepayments		(250)	978
Increase in other current and non-current assets		(2,398)	(71)
(Increase) / decrease in inventories		(1,010)	496
Increase / (decrease) in accounts payable and accrued charges		1,961	(664)
Increase in taxes payable other than income tax		263	364
Decrease in other long term liabilities		(112)	-
Cash provided by operating activities		**9,120**	**8,839**
Income tax paid		(832)	(132)
Net cash provided by operating activities		**8,288**	**8,707**
CASH FLOW FROM INVESTING ACTIVITIES			
Additions to property, plant and equipment	8	(8,016)	(5,635)
Advances to contractors	9	(2,065)	-
Proceeds from sale of property, plant and equipment		152	96
Net cash used in investing activities		**(9,929)**	**(5,539)**
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from current debt		11,542	7,274
Proceeds from non-current debt		-	2,360
Repayment of debt		(6,664)	(12,276)
Interest paid		(839)	(695)
Dividends paid		(523)	(547)
Purchase of treasury shares		(353)	(193)
Proceeds from sale of treasury shares		358	179
Net cash provided by / (used for) financing activities		**3,521**	**(3,898)**
Effect of inflation on cash and cash equivalents		-	(303)
Increase / (decrease) in cash and cash equivalents		**1,880**	**(1,033)**
Cash and cash equivalents at the beginning of year		**1,663**	**2,696**
Cash and cash equivalents at the end of year		**3,543**	**1,663**

General Director — Evstafiev A.V.

Chief Accountant — Dronova T.P.

30 March 2004

JSC Mosenergo
Consolidated Statement of Changes in Shareholders' Equity for the year ended 31 December 2003
(in millions of Russian Roubles)

	Share capital, ordinary shares	Treasury shares	Accumulated deficit	Total shareholders' equity
At 31 December 2001	154,720	-	(67,469)	87,251
Net loss	-	-	(2,341)	(2,341)
Dividends	-	-	(547)	(547)
Purchase of treasury shares	-	(193)	-	(193)
Sale of treasury shares	-	179	-	179
At 31 December 2002	**154,720**	**(14)**	**(70,357)**	**84,349**
At 31 December 2002	154,720	(14)	(70,357)	84,349
Net profit	-	-	737	737
Dividends	-	-	(519)	(519)
Purchase of treasury shares	-	(353)	-	(353)
Sale of treasury shares	-	358	-	358
At 31 December 2003	**154,720**	**(9)**	**(70,139)**	**84,572**

General Director Evstafiev A.V.

Chief Accountant Dronova T.P.

30 March 2004

Note 1: The Group and its operations

Open Joint-Stock Company Mosenergo (JSC Mosenergo) is a regional utility company providing electric power and heat generation and distribution services to the city of Moscow, Moscow region and surrounding regions. Operations of JSC Mosenergo include approximately 14,779 megawatts ("MW") of installed generating capacity for electricity and 34,880 gigacalories ("Gkal") of installed generating capacity for heat. Additionally, JSC Mosenergo purchases electricity from the Federal Wholesale Market for Electricity and Capacity ("FOREM") as determined by the operating needs of JSC Mosenergo.

The principal operating units of JSC Mosenergo are:

- 16 TETS (heat and electricity generating plants);
- 4 GRES (electricity generating plants);
- 1 GAES (hydro accumulation plant);
- 16 Electricity distribution grids;
- 1 Heat distribution grid.

JSC Mosenergo was registered in the Russian Federation on 06 April 1993 in accordance with State Property Management Committee Decree No 169-R dated 26 March 1993. In accordance with the privatisation of the Russian electric utility industry, JSC Mosenergo was organised as a joint-stock company and certain assets and liabilities formerly under the control of the Ministry of Energy of the Russian Federation were assumed at their net book value.

At 31 December 2003, 50.9 percent ownership interest is controlled by the Russian Open Joint Stock Company Unified Energy System of Russia ("RAO UES"), which was created as the holder of certain significant electricity power generation, transmission and distribution assets during the industry privatisation. This 50.9 percent ownership by RAO UES represents 14,379,166,000 of JSC Mosenergo’s ordinary shares.

JSC Mosenergo and its subsidiaries (hereinafter "the Group") are incorporated under the laws of the Russian Federation (the "state"). The principal subsidiaries of the Group are disclosed in Note 6.

At 31 December 2003, the number of employees of the Group was approximately 48 thousand (31 December 2002 approximately 49 thousand).

The Group’s registered office is located at 8 Raushskaya Naberezhnaya, Moscow, 115035, Russia.

Relations with the state. At 31 December 2003, the government of the Russian Federation owned 52.7 percent of RAO UES, who owned 50.9 percent of the voting ordinary shares of JSC Mosenergo.

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 Energy Commission ("FEC") subsequently renamed to Federal Service on Tariffs (FST), with respect to its wholesale energy purchases, and by the Moscow and Moscow region Regional Energy Commissions ("RECs"), with respect to its retail electricity and heat sales. The operations of all generating facilities are co-ordinated by The System Operator-Central Dispatch Unit of Unified Energy System (SO-CDU) in order to meet system requirements in an efficient manner; these entities are controlled by RAO UES.

Tariffs which the Group may charge for sales of electricity and heat are governed by regulations both 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 the International Financial Reporting Standards ("IFRS") basis of accounting. 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.

Note 1: The Group and its operations (continued)

As a condition to privatisation in 1992, the government of the Russian Federation imposed an obligation on regional utility companies to provide connection with respect to 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 Note 22, the government's economic, social and other policies could have material effects on the operations of the Group.

Regulatory and sector restructuring. The Russian electric utilities industry in general and the Group in particular are presently undergoing a restructuring process designed to introduce competition into the electricity sector and to create an environment in which the Group and its successor companies can raise the capital required to maintain and expand current capacity. The regulatory framework governing the process of reforming the Russian Federation electric utilities industry and the functioning of the industry, both during the transition period and subsequent to the completion of reforms, is set forth in the following legislation: Federal Law No. 35-FZ of 26 March 2003 "On the Electric Utilities of the Russian Federation" and Federal Law No. 36-FZ of 26 March 2003 "On the Specifics of the Functioning of Electric Utilities During the Transition Period and the Introduction of Amendments to Certain Russian Federation Legislative Acts and the Invalidation of Certain Russian Federation Legislative Acts in Connection with the Adoption of the Law "On the Electric Utilities of the Russian Federation".

- In April 2003, legislation underlying the electric utilities reform effort took effect. This legislative package, consisting of six laws drafted by the Russian Federation government, defines the key areas in the industry reform program, as well as the terms and conditions under which electric utilities will function both during the transition period and following the reforms.

- At the present stage, bills are being drafted for the specific legislative acts envisioned under the aforementioned laws on electric utilities reform according to the action plan related to electric utilities reform and adopted by the resolution of the Russian Federation government of 27 June 2003 No 865-r (p). RAO UES has been playing an active role in drafting these pieces of legislation.

- In early September 2003 the Russian Federation government issued Resolution No. 1254-r (p) approving the structures of generating companies in the wholesale electricity market. According to the aforementioned resolution 10 generating companies (4 – based on hydro generating power plants and 6 based on heat generating power plants), which will include the electric power plants owned by OAO RAO UES and its subsidiaries, will be established.

- In October 2003, the Russian Federation government issued Resolution No. 643 "On the Rules for the Wholesale Electricity (Power) Market during the Transition Period". According to the rules adopted, there will be two sectors within the Federal Wholesale Electricity (Power) Market: regulated trading sector and free trading sector. Within the free trading sector, electricity suppliers will be able to sell electricity generated with the use of facilities and equipment accounting for 15 percent of the load capacity. Since November 2003, the non-commercial partnership "Trade System Administrator of the Wholesale Electricity Market", in accordance with the rules for the wholesale electricity (power) market during the transition period, has been conducting auctions for the sale of electricity in the free trading sector. According to the laws underlying the electric utilities reform, in due course free trading will be extended over the whole volume of trading.

- The Federal Grid Company – JSC FGC UES ("FGC") – was established in June 2002, as a wholly-owned subsidiary of RAO UES, to manage the transmission of electricity through the use of transmission assets received or earmarked for receipt from RAO UES and its subsidiaries.

- SO-CDU – was established in June 2002 to perform electricity dispatch functions within the unified electricity system of the Russian Federation.

Note 1: The Group and its operations (continued)

- On 29 May 2003 the Board of Directors of RAO UES approved a Concept of the RAO UES Group's strategy for the period from 2003 through 2008. This document provides a detailed description of the major changes that are slated to take place in the RAO UES Group during the electric utilities reform program, including the various stages in the process of establishing participant entities, based on the RAO UES Group, in both the wholesale and retail electricity markets, and the key areas for further development of the organizations thereby being established.

In September 2003, RAO UES entered into the Agreements on Cooperation in Reorganizing the Energy Complex of the City of Moscow and the Moscow Region with the government of Moscow City and the government of Moscow Region (the "Agreements"), which establish the key provisions for reforming the Moscow City and Moscow Region energy complex as part of the restructuring of the federal energy sector. The Agreements contemplate the reorganization of JSC Mosenergo into various open joint stock companies with a distribution of shares in the newly created companies to the Company's shareholders, on a pro rata basis with their existing shareholding. The Agreements also set forth specific steps that have to be implemented and list all approvals to be obtained in the course of the restructuring.

JSC Mosenergo is engaged in all energy-production related activities, including generation, transmission, distribution and supply of heat and electrical energy. In accordance with the Agreements, JSC Mosenergo adopted certain guidelines for the implementation of its restructuring which included significant terms of restructuring (the "Guidelines"). These Guidelines were approved by the Board of Directors of RAO UES on 30 January, 2004 and adopted by the Board of Directors of JSC Mosenergo on 4 March, 2004. The decision about reorganization of JSC Mosenergo, terms of restructuring and other more detailed documents will need to be formally approved by the JSC Mosenergo shareholders at the AGM. The first step of the restructuring is to "spin-off" various activities. By means of the spin-off, JSC Mosenergo intends to:

- separate its monopolistic lines of business (transmission, distribution) from competitive lines of business (generation and supply);
- develop competition in the retail (consumer) energy market;
- phase-out cross-subsidies among energy market participants; and
- create real economic incentives for energy generators to reduce costs and expenses, modernize their facilities and increase management and operational efficiencies.

If the spin-off is approved by the shareholders at the AGM, thirteen spun-off companies will be formed each of which will be independent of JSC Mosenergo. The spun-off companies will not be pre-existing subsidiaries of the Group. Each spun-off company will be established as a Russian open joint stock company.

JSC Mosenergo will continue to own and operate the key electricity and heat generation assets. Certain other assets and liabilities of JSC Mosenergo will be transferred to each spun-off company.

On completion of the restructuring, neither JSC Mosenergo nor any of the spun-off companies will own any capital stock in any other spun-off company. JSC Mosenergo and each spun-off company will initially have the same shareholders as the Company, and, consequently, they will all continue to be controlled by the same shareholder, RAO UES. In the spin-off, each shareholder of JSC Mosenergo will become a shareholder of each spun-off company.

At this time, the impact of the industry changes on both the financial results and position of the Group can not be readily assessed because the specific, detailed mechanisms to effect the restructuring are still being determined. Accordingly, no provision has been recognised for any possible eventual effects of the restructuring process.

Note 2: Economic environment in the Russian Federation

Economic environment in the Russian Federation. Whilst there have been improvements in the economic situation in the Russian Federation in recent years, the country continues to display some characteristics of an emerging market. These characteristics include, but are not limited to, the existence of a currency that is not freely convertible in most countries outside of the Russian Federation, restrictive currency controls, and relatively high inflation.

The prospects for future economic stability in the Russian Federation are largely dependent upon the effectiveness of economic measures undertaken by the government, together with legal, regulatory, and political developments.

Note 3: Financial condition

As discussed above, the Group is significantly affected by government policy through control of tariffs and other factors. In recent years the Regional Energy Commissions have not always permitted tariff increases in line with inflation and thus some tariffs are insufficient to cover all the costs of generation and distribution. Moreover, these tariffs consider costs only on a Russian statutory basis and, accordingly, exclude significant additional costs recognised under IFRS basis of accounting. As a result, tariffs often do not allow for an adequate return or provide sufficient funds for the full replacement of property, plant and equipment.

The Group continues to experience problems in obtaining settlement of old accounts receivable. Management has improved significantly the absolute level of settlements for current sales. Currently substantially all settlements of accounts receivables are made in cash. Despite this success, there still remains a significant level of uncollected accounts receivable from earlier periods. There is legislation enabling the Group to cut off non-payers, but this is only practical to a limited extent. In addition, market reforms have reduced the budgets for many governmental organisations, adversely impacting their ability to pay for old and current supplies. Federal, municipal and other governmental organisations make up a significant proportion of the debtor balance as at 31 December 2003.

Management's continuing efforts to improve the Group's financial position concentrate primarily on the following areas:

- collection of old receivables, including such measures as court action, seizure of debtors' assets, restriction of energy and/or heat supply, etc.;
- restructuring and refinancing liabilities to suppliers, mainly to gas companies. A long-term loan of RR 2,334 million (at historic value) with a 10 percent-interest rate received from a related party in late 2001 (see Note 7) enabled the Group to fully settle its current liability to the major gas supplier;
- obtaining additional tariff increases. In February – March 2003 the average tariffs increased by approximately 19 percent for electricity and by approximately 15 percent for heat.

Management is confident that its continuing efforts will result in improvements in the Group's profitability and liquidity.

(in millions of Russian Roubles)

Note 4: Basis of presentation

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS). The Group's parent, RAO UES, similarly prepares consolidated financial statements in accordance with IFRS.

The Group maintains its books of accounts and prepares its statutory financial statements in accordance with RAR. These financial statements are based on the statutory records, which are maintained under the historical cost convention method, with adjustments and reclassifications for the purpose of fair presentation in accordance with IFRS.

The preparation of consolidated financial statements in accordance with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management's best knowledge of current event and actions, actual results ultimately may differ from those estimates.

Inflation accounting. Prior to 1 January 2003 the adjustments and reclassifications made to the statutory records for the purpose of IFRS presentation included the restatement of balances and transactions for the changes in the general purchasing power of the RR in accordance with IAS 29 ("Financial Reporting in Hyperinflationary Economies"). 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. As the characteristics of the economic environment of the Russian Federation indicate that hyperinflationary has ceased, effective from 1 January 2003 the Group no longer applies the provisions of IAS 29. Accordingly, 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.

Corresponding figures, for the year ended 31 December 2002, were restated for the changes in the general purchasing power of the RR at 31 December 2002. The restatement was calculated using the conversion factors derived from the Russian Federation Consumer Price Index ("CPI"), published by the Russian State Committee on Statistics ("Goscomstat"), and from indices obtained from other sources for years prior to 1992. The indices used to restate corresponding figures, based on 1988 prices (1988 = 100) for the five years ended 31 December 2002, and the respective conversion factors, are:

Date	Index	Conversion Factor
31 December 1998	1,216,400	2.24
31 December 1999	1,661,481	1.64
31 December 2000	1,995,937	1.37
31 December 2001	2,371,572	1.15
31 December 2002	2,730,154	1.00

The main guidelines followed in restating the corresponding figures were:

- All corresponding amounts were stated in terms of the measuring unit current at 31 December 2002;
- Monetary assets and liabilities held at 31 December 2002 were not restated because they were already expressed in terms of the monetary unit current at 31 December 2002.
- The appraisal values of property, plant and equipment and the impact of any impairment have been restated by applying relevant conversion factors beginning with the appraisal date together with adjustments for additions, disposals and depreciation, all restated by applying the relevant conversion factors;

Note 4: Basis of presentation (continued)

- Non-monetary assets and liabilities (those balance sheet items that were not expressed in terms of the monetary unit current at 31 December 2002) and components of shareholders' equity were restated from their historical cost by applying the change in the general price index from the date the non-monetary item originated to 31 December 2002.

- Gains or losses that arose as a result of holding monetary assets and liabilities for the reporting period ended 31 December 2002 were included in the consolidated income statement as a monetary gain or loss.

Note 5: Summary of significant accounting policies

Principles of consolidation. These consolidated financial statements comprise the financial statements of JSC Mosenergo and the financial statements of those entities in which the Group has an interest of more than one half of the voting rights, or otherwise has power to exercise control over the operations. Subsidiaries are consolidated from the date on which control is transferred to the Group and are no longer consolidated from the date that control ceases. All intercompany transactions, balances and unrealised gains on transactions between group companies are eliminated; unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

Foreign currency. Monetary assets and liabilities which are held by the Group and denominated in foreign currencies at the balance sheet date are translated into Russian Roubles at the exchange rates prevailing at that date. Foreign currency transactions are accounted for at the exchange rates prevailing at the date of the transaction. Gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in the consolidated income statement.

The official rate of exchange, as determined by the Central Bank of the Russian Federation, between the Russian Rouble and the US Dollar ("US$") at 31 December 2003 was RR 29.45:US$1 (31 December 2002: RR 31.78:US$1). Exchange restrictions and controls exist relating to converting the Russian Rouble into other currencies. At present, the Russian Rouble is not a convertible currency outside of the Russian Federation.

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.

Property, plant and equipment. Property, plant and equipment as at 31 December 2003 is stated at depreciated replacement cost, based upon values determined by third party valuation at 31 December 1997, and adjusted for subsequent additions at cost, disposals and depreciation, and restated for the impact of inflation prior to 31 December 2002. 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 net selling price or its value in use. The carrying amount is reduced to the recoverable amount and the difference is recognised as an expense (impairment loss) in the consolidated income statement. An impairment loss recognised 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. This 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. 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. The change in carrying value arising from this valuation was recorded directly to retained earnings.

Major renewals and improvements are capitalised and the assets replaced are retired.

Interest costs on borrowings to finance the construction of property, plant and equipment are capitalised, during the period of time that is required to complete and prepare the asset for its intended use. All other borrowing costs are expensed.

Note 5: Summary of significant accounting policies (continued)

Maintenance, repairs and minor renewals are expensed as incurred. Minor renewals include all expenditures that do not result in a technical enhancement of the asset beyond its original capability. Gains and losses arising from the retirement of property, plant and equipment are included in the consolidated income statement as incurred.

Depreciation of property, plant and equipment is calculated on a straight-line basis over the estimated useful life of the asset. The average useful lives of assets by type of facility are as follows:

Type of facility	Years
Electricity and heat generation	17 to 50
Electricity distribution	11 to 25
Heating networks	14 to 20
Other	10

Social assets are excluded from the financial statements as they are not expected to result in future economic benefits to the Group. However, costs for social responsibilities are expensed as incurred.

Cash. Cash comprises cash in hand and cash deposited in banks "payable on demand".

The statement of cash flows has been prepared in accordance with IAS 7 "Cash Flow Statements". The total of operating activities represents actual cash flow transactions from operations. However, individual items within this part of the statement of cash flows are stated inclusive of both cash and non-cash transactions. Management believes that the benefits of providing individual cash items within operating activities are outweighed by the cost of preparation.

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 a provision made for impairment of these receivables. Such a provision for impairment of receivables 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 provision 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 similar borrowers at the date of origination of the receivables.

Value added tax. Value added taxes related to sales is payable to tax authorities upon collection of receivables from customers. Input VAT is reclaimable against sales VAT upon payment for purchases. The tax authorities permit the settlement of VAT on a net basis. VAT related to sales and purchases which have not been settled at the balance sheet date (VAT deferred) is recognised in the balance sheet on a gross basis and disclosed separately as a current 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. The related VAT deferred liability is maintained until the debtor is written off for tax purposes.

Inventories. Inventories are valued at the lower of net realisable value and weighted average cost. Provision is made for potential losses on obsolete or slow-moving inventories, taking into account their expected use and future realisable value.

Deferred income taxes. Deferred income tax assets and liabilities are calculated in respect of temporary differences using a balance sheet liability method for financial reporting and accounting for deferred income taxes. Deferred income taxes are provided for all temporary differences arising between the tax basis of assets and liabilities and their carrying values for financial reporting purposes. A deferred income 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 income 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.

Note 5: Summary of significant accounting policies (continued)

Accounts payable and accrued charges. Accounts payable are stated inclusive of value added taxes which are reclaimable from tax authorities upon the later of receipt of goods or services and settlement of the payable.

Debt. Debt is recognised initially at the fair value of the proceeds received, net of transaction costs incurred. Fair value is determined with reference to market interest rates applicable to the Group when the debt was incurred. In subsequent periods, debt is stated at amortised cost; any difference between the fair value of the proceeds (net of transaction costs) and the redemption amount is recognised in the consolidated income statement as an interest expense over the period of the debt obligation.

Minority interest. Minority interest at the balance sheet date represents the minority shareholders' portion of the pre-acquisition carrying amounts of the identifiable assets and liabilities of the subsidiary at the acquisition date, and the minorities' portion of movements in equity since the date of the combination. Minority interest is presented separately from liabilities and shareholders’ equity.

Pension and post-employment benefits. The Group’s 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 consolidated income statement, however, separate disclosures are not provided, as these costs are not material.

Provisions. Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made. Where the Group expects a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

Segment information. The Group operates predominantly in a single geographic area and industry; the generation, distribution and sale of electric power and heat in the City Moscow, Moscow region and the surrounding regions. It is not feasible to identify distinguishable business segments for electric power and heat production.

Revenue recognition*.* Revenue is recognised on the delivery of electricity and heat, and on the despatch of non-utility goods and services. Revenue amounts are presented exclusive of value added taxes.

Revenue is based on the application of authorised tariffs for electricity and heat sales as approved by the RECs.

Treasury shares. Where the Group or its subsidiaries purchase JSC Mosenergo's shares, the consideration paid, including any attributable transaction costs, net of income taxes, is deducted from total shareholders' equity as treasury shares until they are cancelled or sold. Where such shares are subsequently sold, any consideration received is included in shareholders' equity. Treasury shares are stated at weighted average cost, restated for inflation as at the balance sheet date.

Note 6: Principal subsidiaries

The principal subsidiaries consolidated in the Group’s Financial Statements are disclosed in table below:

Name	Location	Percent of ownership	Activity
KB Transinvestbank (OOO)	Russian Federation, Moscow	72 %	Banking
ZAO Electricity sales servicing Centre	Russian Federation, Moscow	72 %	Electricity and heat sales services

(in millions of Russian Roubles)

Note 7: Related Parties

RAO UES. RAO UES owns 50.9 percent of the ordinary voting shares of JSC Mosenergo and has effective control over the Group's operations. RAO UES charges the Group a transmission fee at the tariffs approved by the FEC, for the use of the electricity grids. The Group also has a loan due to RAO UES. The loan is payable in quarterly installments between 2002 and 2005. The loan was used in full for the repayment of liabilities to OOO Mezhregiongas, a subsidiary of JSC Gazprom.

FOREM transactions *(see Note 1).* All sales to and purchases from the unified national grids are contracted with electric and heat companies (Energos) at established and regulated tariffs. Technological management of the unified national grids is performed by SO-CDU (a subsidiary of RAO UES). Most of the electric and heat companies (Energos) are subsidiaries of RAO UES.

JSC Insurance company Leader. In December 2002, the Group concluded a contract for property insurance for 2003 with an insurance company, Leader, which is a 100 percent owned subsidiary of RAO UES.

Balances and transactions with related parties of the Group as at and for the periods ended 31 December 2003 and 31 December 2002 were as follows:

	Revenue / (costs) for the year ended		Accounts receivable / (payable) as at	
	31 December 2003	**31 December 2002**	**31 December 2003**	**31 December 2002**
Transmission fee				
RAO UES	(3,882)	(4,152)	-	-
SO-CDU	(109)	(22)	(7)	-
FGC	(913)	-	(59)	-
FOREM transactions				
Purchased power				
JSC Ryzanskaya GRES	(181)	(390)	-	(33)
JSC Tyumenenergo	(136)	(186)	-	(68)
JSC Kostromskaya GRES	(106)	(128)	-	-
JSC Troitskaya GRES	(64)	-	-	-
Other	(132)	(131)	-	(37)
Advances given to suppliers				
JSC Tyumenenergo	-	-	-	47
Other	-	-	-	28
Revenue from sales of electricity				
JSC Kuzbassenergo	-	-	-	281
JSC Tverenergo	-	-	46	111
Other	-	-	-	39
Penalties and interest received (included in other revenue)				
JSC Tverenergo	30	23	37	67
JSC Voronezhenergo	35	-	49	84
JSC Saratovenergo	-	-	3	3
Insurance costs				
Settlements with insurance company Leader	(1,089)	(9)	-	791

(in millions of Russian Roubles)

Note 7: Related Parties (continued)

	Change in the balance for the year ended		Balance due as at	
	31 December 2003	31 December 2002	31 December 2003	31 December 2002
Loan from RAO UES				
Principal amount	-	-	(1,122)	(1,468)
Interest accrued (see Note 19)	(332)	(425)	-	-
Repaid during the year	678	659	-	-

Directors' remuneration. Total remuneration paid to the members of the Board of Directors and Management Board for the year ended 31 December 2003 was RR 42,624 thousand (for the year ended 31 December 2002 – RR 32,894 thousand).

Note 8: Property, plant and equipment

Appraisal value or cost	Electricity and heat generation	Electricity distribution	Heating networks	Construction in progress	Other	Total
Opening balance as at 31 December 2002	93,388	36,337	19,031	5,209	41,213	195,178
Additions	3	1	-	8,208	7	8,219
Transfers	2,365	2,918	1,625	(8,299)	1,391	-
Disposals	(774)	(194)	(1)	-	(422)	(1,391)
Closing balance as at 31 December 2003	94,982	39,062	20,655	5,118	42,189	202,006
Accumulated depreciation (including impairment)						
Opening balance as at 31 December 2002	(45,177)	(16,211)	(11,603)	-	(27,136)	(100,127)
Charge for the period	(3,589)	(1,529)	(961)	-	(2,743)	(8,822)
Disposals	679	153	1	-	405	1,238
Closing balance as at 31 December 2003	(48,087)	(17,587)	(12,563)	-	(29,474)	(107,711)
Net book value as at 31 December 2003	46,895	21,475	8,092	5,118	12,715	94,295
Net book value as at 31 December 2002	48,211	20,126	7,428	5,209	14,077	95,051

Construction in progress represents the carrying amount of property, plant and equipment that has not yet been put into production.

Depreciation of these assets starts after they are put into operation.

Other fixed assets include motor vehicles, computer equipment, office fixtures and other assets not included in categories mentioned above.

(in millions of Russian Roubles)

Note 8: Property, plant and equipment (continued)

A portion of property, plant and equipment additions and disposals has been settled through mutual settlement, barter and other non-cash means. Non-cash transactions in respect of property, plant and equipment were:

	Year ended 31 December 2003	Year ended 31 December 2002
Non-cash acquisitions	(34)	-
Interest capitalised	(169)	(73)
Non-cash proceeds from the sale of property, plant and equipment	860	-

Impairment. For the period ended 31 December 2003, management has assessed the adequacy of its existing impairment provision and concluded that the amount is appropriate. Accordingly, no further adjustment has been recorded in consolidated financial statements for the year ended 31 December 2003. The impairment provision included in the accumulated depreciation balance as at 31 December 2003 was RR 35,830 million (at 31 December 2002 – RR 40,302 million).

Note 9: Other non-current assets

	31 December 2003	31 December 2002
Advances to contractors	2,424	-
Long-term trade receivables (Net of provision for impairment of receivables of RR 200 million as at 31 December 2003 and RR 287 million as at 31 December 2002)	360	342
Investments	87	69
Other	675	217
	3,546	628

Advances to contractors as at 31 December 2003 include advances to JSC Moscapstroy in an amount of RR 2,065 million for the construction under a Moscow government investment program. A loan from Alfa Bank received during 2003 was used to finance this construction (see Note 15).

Note 10: Inventories

	31 December 2003	31 December 2002
Fuel production stocks (at cost)	2,782	1,621
Materials and supplies (at cost)	1,485	1,645
Other inventories (at cost)	105	96
	4,372	3,362

Materials and supplies are shown net of provision for obsolete stock of RR 457 million as at 31 December 2003 and RR 316 million as at 31 December 2002.

(in millions of Russian Roubles)

Note 11: Accounts receivable and prepayments

	31 December 2003	31 December 2002
Trade receivables (Net of provision for impairment of receivables of RR 3,117 million as at 31 December 2003 and RR 2,997 million as at 31 December 2002)	4,157	5,307
Value added tax recoverable	1,747	1,263
Advances given to suppliers	1,688	883
Prepayments	216	1,031
Other receivables (Net of provision for impairment of receivables of RR 20 million as at 31 December 2003 and RR 997 million as at 31 December 2002)	903	533
	8,711	9,017

Management has determined the provision for impairment of receivables based on specific customer identification, payment trends, subsequent receipts and settlements and analyses of expected future cash flows. Based on the expected collection rate, discount rates of 17-19 percent have been used in the estimate of fair value of future cash flows. The effects of discounting are reflected in the provision for impairment of receivables and expense. Management believes that the Group will be able to realize the net receivable amount through direct collections and other non-cash settlements and that therefore the recorded value approximates their fair value.

The above prepayments balance included RR 160 million and RR 833 million of prepayments for insurance at 31 December 2003 and 31 December 2002 respectively.

At 31 December 2003 and 31 December 2002, the above other receivables balance included RR 500 million and RR 154 million of tax overpayments, respectively. The balance of tax overpayments at 31 December 2003 included RR 328 million of Road User Tax ("RUT") overpaid by the Group in prior periods and due to be returned by the tax authorities as a result of a court decision; the overpaid RUT resulted from the application of an incorrect tax rate for the year 2000. Some uncertainty exists concerning the settlement procedure of the RUT balance by the tax authorities. The residual element of tax overpayments as at 31 December 2003 are to be settled against future tax liabilities.

The above accounts receivable and prepayments included balances from the related parties of RR 135 million and RR 1,451 million at 31 December 2003 and 31 December 2002 respectively (see Note 7).

Note 12: Cash

	31 December 2003	31 December 2002
Cash at bank and in hand	3,531	1,644
Foreign currency bank accounts	12	19
	3,543	1,663

Cash balances do not include the amounts of mandatory reserves held by KB Transinvestbank (OOO), a subsidiary of JSC Mosenergo, in the Central Bank of Russia for the amounts of RR 291 million and RR 83 million as at 31 December 2003 and 31 December 2002 respectively, and balances on special accounts in JSC ABN AMRO bank and JSC KB Citibank in amounts of RR 152 million and RR 177 million as at 31 December 2003 and 31 December 2002 respectively. Latter balances are allotted to 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.

(in millions of Russian Roubles)

Note 13: Shareholders' equity

Share Capital	Number of shares issued and fully paid	31 December 2003	31 December 2002
Ordinary shares	28,267,726,000	154,720	154,720
	28,267,726,000	154,720	154,720

The issued number of ordinary shares is 28,267,726,000 with a nominal value per share of 1 Russian Rouble. In addition, a further 812,274,000 of shares have been authorised but have not yet been issued. The value of the share capital is stated in terms of the purchasing power of the Russian Rouble at the balance sheet date.

Dividends. Dividends for the year ended 31 December 2002 approved by the Annual General Meeting on 30 May 2003 were 0.01837 RR per ordinary share.

Treasury shares. At 31 December 2003 KB Transinvestbank (OOO), a 72 percent owned subsidiary of the Group, owned 0.02 percent of the ordinary shares of JSC Mosenergo. These ordinary shares carry voting rights in the same proportion as other ordinary shares of JSC Mosenergo. Voting rights carried by these shares are effectively controlled by management of the Group. Treasury shares as at 31 December 2003 represent 4,696,789 ordinary shares (31 December 2002: 13,732,600).

Note 14: Non-current debt

	Currency	Interest rate	Due	31 December 2003	31 December 2002
IFC	US dollar	LIBOR+3.5%	2004 – 2009	397	500
EBRD	US dollar	LIBOR+3.5%	2004 – 2009	596	750
EBRD	US dollar	LIBOR+4.0%	2004 – 2007	1,716	2,225
Ljubljana Bank	EURO	EURIBOR+3.375%	2003	-	58
RAO UES (see Note 7)	RR	23.1 – 23.2%	2004 – 2005	1,122	1,468
Total non-current debt				3,831	5,001
Less current portion				(1,105)	(1,100)
				2,726	3,901

RAO UES loan is shown at its fair value. The historic value of the above loan as at 31 December 2003 was RR 1,166 million (31 December 2002: RR 1,749 million). Fair values of other loans approximated their historical values.

EBRD and IFC loans. These loans were obtained in April 1998 to finance construction of Zagorskaya GAES, one of the principal operating units. Loans from EBRD and IFC were received under non-revolving line of credit agreements (loan amount not to exceed US$ 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.

Certain equipment with net book value amounted to RR 988 million of one of the principal operating units is pledged as collateral for the loans.

(in millions of Russian Roubles)

Note 14: Non-current debt (continued)

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

RAO UES loan. This loan was obtained from CARES for the repayment of debt to a gas supplier. The loan was obtained from CARES on 25 December 2001 in the amount of RR 2,334 million (at historic value) bearing interest of 10 percent. Subsequently CARES assigned the right of demand to RAO UES. The debt to RAO UES has been recorded net of discounts, calculated at a discount rate of 23.1–23.2 percent (see Note 19).

The long-term loans have the following maturity profile:

Maturity table	**31 December 2003**	**31 December 2002**
Due for payment		
Between one and two years	1,136	1,075
Between two and five years	1,424	2,468
After 5 years	166	358
	2,726	3,901

Note 15: Current debt and current portion of non-current debt

	Currency	**Interest rate**	**31 December 2003**	**31 December 2002**
Agropromkredit	RR	16.00-17.00%	1,500	250
Alfa Bank	RR	14.00-15.00%	3,406	-
Eurofinance	RR	15.00%	701	300
Bank of Moscow	RR	12.50-16.00%	1,500	500
International Industrial Bank	RR	15.00%	1,000	1,002
Current portion of non-current debt			1,105	1,100
			9,212	3,152

As at 31 December 2003 the current portion of non-current debt included a part of RAO UES loan with the fair value of RR 561 million: (historic value of RR 583 million); 31 December 2002: fair value of RR 489 million (historic value of RR 583 million) (see Notes 14 and 19). Fair values of other loans approximated their historical values.

The loans from the Bank of Moscow are secured against fuel inventory.

Alfa Bank. The first tranche of the loan from Alfa Bank was obtained in September 2003 to finance construction undertaken under a Moscow government investment program. The loan was received under a revolving line of credit agreement, limited to RR 2,000 million in total. Interest on the loan is paid on a monthly basis and capitalized. The interest rates for the line of credit are 14–15 percent. Other loans from Alfa Bank were obtained for working capital financing.

(in millions of Russian Roubles)

Note 16: Income tax

	Year ended 31 December 2003	Year ended 31 December 2002
Current income tax charge	(1,176)	(752)
Deferred income tax benefit/(charge)	1,218	(1,189)
Total income tax benefit/(charge)	42	(1,941)

Loss before income tax for financial reporting purposes is reconciled to the income tax benefit/(charge) as follows:

	Year ended 31 December 2003	Year ended 31 December 2002
Income/(loss) before income tax	793	(380)
Theoretical income tax (charge)/benefit at an average statutory tax rate of 24 percent thereon	(190)	91
Tax effect of items which are not deductible or assessable for taxation purposes:		
- Non-temporary elements of monetary gains/losses	-	(3,043)
- Effect from release of provision for impairment of receivables	-	182
- Non-deductible expenses, net	(302)	(322)
Inflation effect on deferred income tax balance at beginning of the period and current income tax charge	-	1,265
Effect of change in tax base of accounts receivable (see Note 18)	564	-
Other effects	(30)	(114)
Total income tax benefit/(charge)	42	(1,941)

Deferred income tax. Differences 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 income tax purposes. Deferred income tax assets and liabilities are measured at 24 percent, the rate applicable when the asset or liability will reverse.

Deferred income tax liability	**31 December 2003**	**Benefit recognised in income statement**	**31 December 2002**	**Charge / (benefit) recognised in income statement**	**31 December 2001**
Property, plant and equipment	10,168	(487)	10,655	1,688	8,967
Trade receivables	(769)	(676)	(93)	(458)	365
Other	(141)	(55)	(86)	(41)	(45)
	9,258	(1,218)	10,476	1,189	9,287

(in millions of Russian Roubles)

Note 17: Accounts payable and accrued charges

	31 December 2003	31 December 2002
Trade payables	2,767	2,605
Financing from Moscow Government	1,997	1,309
Accrued liabilities and other creditors	2,938	2,022
	7,702	5,936

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

The above accounts payable and accrued charges include accounts payable to related parties in the amount of RR 66 million and RR 138 million at 31 December 2003 and 31 December 2002respectively (see Note 7).

Note 18: Taxes payable

	31 December 2003	31 December 2002
Value added tax	1,917	1,526
Income tax (see Note 16)	549	163
Property tax	246	244
Employee taxes payable	92	97
Turnover taxes	-	143
Other taxes	107	89
	2,911	2,262

Included within value added tax payable at 31 December 2003 is RR 1,355 million (at 31 December 2002: RR 931 million) of value added tax that is only payable to the tax authorities when the underlining receivable is recovered or written off.

Prior to 2003, the Group did not intend to write off certain doubtful debtors for tax reporting purposes and as a result the Group did not record a deferred income tax asset in respect of such debtors, as it was not probable that this asset would be realised. In addition, as VAT is payable when cash is collected or receivables are written off for tax reporting purposes, the VAT related to these doubtful debtors was not deemed payable and was therefore not recognized as a liability. During 2003, these positions were reconsidered by management and doubtful debts are now being written off for tax reporting purposes. Consequently, an additional deferred tax asset and an additional liability for VAT of RR 564 million (see Note 16) and RR 547 million, respectively, have been recognised in the balance sheet as at 31 December 2003. The additional VAT was recognised as an expense within the doubtful debtors expense, and the additional deferred tax recognized as a deferred income tax benefit, in the consolidated income statement for the year.

Note 19: Monetary effects and financing items

	Year ended 31 December 2003	Year ended 31 December 2002
Interest expense	(885)	(917)
Foreign exchange gain /(loss)	230	(303)
Monetary gain	-	541
	(655)	(679)

(in millions of Russian Roubles)

Note 19: Monetary effects and financing items (continued)

The fair value of the loan received from RAO UES (see Note 14) at inception was estimated using a discount rate of 23.1–23.2 percent, which resulted in the recognition of a gain for the amount of RR 797 million in the year ended 31 December 2001. In the year ended 31 December, 2003 RR 237 million of the discount was amortized (31 December 2002: RR 386 million). The amortization expense was included into interest expense.

Prior to 31 December 2002 Russian Federation was deemed to be a hyperinflationary economy and, consequently, the Group calculated monetary gains and losses in accordance with IAS 29.

Note 20: Earnings per share

Earnings per share is calculated by dividing the net income attributable to shareholders by the weighted average number of ordinary shares outstanding during the period.

Ordinary Shares	Year ended 31 December 2003	Year ended 31 December 2002
Weighted average number of ordinary shares outstanding (thousands)	28,267,726	28,267,726
Adjusted for weighted average number of treasury shares (thousands)	(19,581)	(6,883)
Weighted average number of ordinary shares outstanding (thousands)	28,248,145	28,260,843
Net income/(loss)	737	(2,341)
Income/(loss) per ordinary share – basic and diluted, in Russian Roubles	0.03	(0.08)

Note 21: Commitments

Fuel commitments. The Group has a number of outstanding fuel contracts. Gas supplies are mostly received from OOO Mezhregiongas, a subsidiary of JSC Gazprom. The gas is supplied under a framework agreement, which was entered into during 2003 and extends until 2007. The quantity of gas to be supplied each year is determined annually. The purchase price of the contract is fixed at the level determined by FEC resolution.

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.

Capital commitments. Future capital expenditures for which contracts have been signed amounted to RR 3,789 million at 31 December 2003 (at 31 December 2002: RR 1,395 million).

Note 22: Contingencies and operating risks

Operating environment. The Russian Federation continues to display some characteristics of an emerging market. These characteristics include, but are not limited to, the existence of a currency that is not freely convertible in most countries outside of the Russian Federation, restrictive currency controls, and relatively high inflation. The tax, currency and customs legislation within the Russian Federation is subject to varying interpretations, and changes, which can occur 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.

Political environment. The operations and earnings of the Group continue, from time to time and in varying degrees, to be affected by political, legislative, fiscal and regulatory developments, including those related to environmental protection, in Russia.

Insurance. The Group held limited insurance policies in relation to its assets, operations, public liability or other insurable risks. Accordingly, the Group is exposed to those risks for which it does not have insurance.

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

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 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. 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.

As at 31 December 2003 management believes that its interpretation of the relevant legislation is appropriate and the Group's tax, currency and customs positions will be sustained. Where management believes it is probable that a position cannot be sustained, an appropriate amount has been accrued for in these financial statements.

Industry changes. As described in Note 1, the Russian Federation Government has passed several resolutions in respect of restructuring the electricity sector in Russia. Management currently is unable to estimate the effects of reforms or the resulting future impact on the financial position of the Group.

Environmental matters. The Group and its predecessor entities have operated in the electric power industry in the Russian Federation for many years. The enforcement of environmental regulation in the Russian Federation is evolving and the enforcement posture of government authorities is continually being reconsidered. Group entities periodically evaluate their obligations under environmental regulations. Potential liabilities might arise as a result of changes in legislation and regulations or civil litigation. The impact of these potential changes 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.

Note 23: Financial instruments and financial risk factors

Financial risk factors. The Group's activities expose it to a variety of financial risks, including the effects of: changes in foreign currency exchange rates, changes in interest rates and the collectibility of receivables. The Group does not have a risk policy to hedge its financial exposures.

Price risk. Price risk includes foreign exchange risk and interest rate risk:

- ***Foreign exchange risk.*** The Group primarily operates within the Russian Federation. The majority of the Group's purchases are denominated in Russian Roubles. The major concentration of foreign exchange risk is in relation to foreign currency denominated borrowings as disclosed in Notes 14 and 15;

- ***Interest rate risk.*** Although significant part of long-term borrowings is at variable interest rates, the largest part of the Group's current debt is at fixed rates (see Notes 14 and 15). Assets are generally non-interest bearing.

Credit risk. Financial assets, which potentially subject the Group to concentrations of credit risk, consist principally of trade receivables. Although collection of receivables could be influenced by economic factors, management believes that there is no significant risk of loss to the Group beyond the provision for impairment of receivables already recorded.

Liquidity risk. Prudent liquidity risk management implies maintaining sufficient cash and marketable securities, the availability of funding through an adequate amount of committed credit facilities and the ability to close out market positions. Due to the dynamic nature of the underlying businesses, Group Treasury aims at maintaining flexibility in funding by keeping committed credit lines available.