AO MOSENERGO

Consolidated interim financial statements
(prepared in accordance with IFRS)
for the three and nine month periods ended 30 September 2008
(unaudited)

AO MOSENERGO
Consolidated Interim Balance Sheets
(in millions of Russian Roubles)

	Note	30 September 2008 (unaudited)	31 December 2007
ASSETS			
Non-current assets			
Property, plant and equipment	7	137,048	122,547
Investment property	8	1,225	1,288
Investments in equity accounted investees	9	1,041	1,246
Advances for acquisition of property, plant and equipment		9,636	8,663
Other non-current assets	13	84	92
Total non-current assets		**149,034**	**133,836**
Current assets			
Inventories	10	4,591	4,444
Investments	11	13,675	23,201
Income tax receivable		633	41
Trade and other receivables	12	13,614	10,344
Other current assets	13	2,227	1,998
Cash and cash equivalents	14	1,525	11,161
Total current assets		**36,265**	**51,189**
Total assets		**185,299**	**185,025**
EQUITY AND LIABILITIES			
Equity	15		
Share capital		166,124	166,124
Treasury stock		(871)	-
Share premium		49,213	49,213
Reserves		37,466	37,534
Accumulated loss		(116,627)	(117,211)
Total equity		**135,305**	**135,660**
Non-current liabilities			
Non-current borrowings	16	15,191	129
Deferred tax liabilities	28	17,854	17,427
Employee benefits	17	943	1,279
Total non-current liabilities		**33,988**	**18,835**
Current liabilities			
Current borrowings and current portion of non-current borrowings	16	1,331	17,476
Trade and other payables	18	13,813	10,950
Income tax payable		152	478
Other taxes payable	19	679	611
Provisions	20	31	1,015
Total current liabilities		**16,006**	**30,530**
Total liabilities		**49,994**	**49,365**
Total equity and liabilities		**185,299**	**185,025**

General Director — V.G. Yakovlev

Chief Accountant — S.A. Suraev

23 December 2008

AO MOSENERGO

Consolidated Interim Statements of Operations

(in millions of Russian Roubles)

	Note	For the three months ended 30 September 2008 (unaudited)	For the three months ended 30 September 2007 (unaudited)	For the nine months ended 30 September 2008 (unaudited)	For the nine months ended 30 September 2007 (unaudited)
Revenue	21	18,014	12,336	66,079	53,164
Cost of materials	22	(11,431)	(8,175)	(37,835)	(29,439)
Other external supplies	23	(2,611)	(2,088)	(12,725)	(11,408)
Personnel expenses	24	(2,622)	(2,253)	(7,423)	(5,616)
Depreciation of property, plant and equipment	7	(1,921)	(1,667)	(5,298)	(5,052)
Taxes other than income tax		(332)	186	(949)	(1,167)
Other operating expenses	25	(880)	(932)	(3,132)	(3,081)
Other operating income	26	411	58	604	249
Results from operating activities		**(1,372)**	**(2,535)**	**(679)**	**(2,350)**
Financial income	27	331	570	1,220	906
Financial expenses	27	(244)	(23)	(827)	(598)
Share of (loss) / profit of equity accounted investees	9	(27)	(7)	(41)	22
Loss before income tax		**(1,312)**	**(1,995)**	**(327)**	**(2,020)**
Income tax benefit / (expense)	28	155	325	(66)	(152)
Loss for the period		**(1,157)**	**(1,670)**	**(393)**	**(2,172)**
Loss per ordinary share (in Russian Roubles):	29				
Basic		(0.03)	(0.06)	(0.01)	(0.07)
Diluted		(0.03)	(0.06)	(0.01)	(0.07)

General Director V.G. Yakovlev

Chief Accountant S.A. Suraev

23 December 2008

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

AO MOSENERGO
Consolidated Interim Statements of Cash Flows
(in millions of Russian Roubles)

	Note	For the nine months ended 30 September 2008 (unaudited)	For the nine months ended 30 September 2007 (unaudited)
Cash flow from operating activities			
Loss before income tax		**(327)**	**(2,020)**
Adjustments for:			
Depreciation		5,306	5,052
Loss on disposal of property, plant and equipment		13	571
Net financial expenses		(523)	(308)
Share of loss / (profit) of equity accounted investees		41	(22)
Trade and other receivables impairment loss		687	234
Other		87	31
Operating profit/(loss) before changes in working capital and provisions		**5,284**	**3,538**
Change in inventories		(132)	(330)
Change in trade and other receivables		(2,985)	(5,210)
Change in restricted cash		(56)	101
Change in trade and other payables		2,879	1,807
Change in taxes payables, other than income tax		91	(255)
Change in provisions and employee benefits		(221)	71
Cash flows from operations before income tax and interest paid		**4,860**	**(278)**
Income tax paid		(558)	(2,069)
Interest paid		(819)	(1,425)
Cash flows from operating activities		**3,483**	**(3,772)**
Cash flows from investing activities			
Proceeds from sale of property, plant and equipment		37	25
Proceeds from disposal of investments		22,911	-
Interest received		177	127
Dividends received		171	49
Acquisition of property, plant and equipment		(20,532)	(19,569)
Acquisition of investments		(13,385)	(21,647)
Interest paid and capitalised		(436)	(786)
Cash flows from investing activities		**(11,057)**	**(41,801)**
Cash flows from financing activities			
Proceeds from the issue of share capital		-	60,720
Costs of the share capital issue		-	(7)
Proceeds from borrowings		-	7,439
Repayment of borrowings		(1,093)	(10,797)
Buy-out of own shares		(969)	-
Dividends paid		-	(743)
Cash flows from financing activities		**(2,062)**	**56,612**
Net (decrease) / increase in cash and cash equivalents		(9,636)	11,039
Cash and cash equivalents at the beginning of the period	14	11,161	5,729
Cash and cash equivalents at the end of the period	14	**1,525**	**16,768**

General Director V.G. Yakovlev

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23 December 2008

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(in millions of Russian Roubles)

	Share capital	Treasury stock	Share premium	Revaluation reserve	Available-for-sale investments revaluation reserve	Accumulated loss	Total
Balance at 31 December 2006 as previously reported	**154,624**	**-**	**-**	**-**	**-**	**(115,510)**	**39,114**
Correction of prior period errors	-	-	-	-	-	(884)	(884)
Balance at 1 January 2007 (restated)	**154,624**	**-**	**-**	**-**	**-**	**(116,394)**	**38,230**
Loss for the period	-	-	-	-	-	(2,172)	(2,172)
Revaluation of property, plant and equipment	-	-	-	37,534	-	-	37,534
Total recognised income and expenses	-	-	-	-	-	-	35,362
Shares issued	11,500	-	49,213	-	-	-	60,713
Dividends to shareholders	-	-	-	-	-	(896)	(896)
Balance at 30 September 2007	**166,124**	**-**	**49,213**	**37,534**	**-**	**(119,462)**	**133,409**
Balance at 1 January 2008	**166,124**	**-**	**49,213**	**37,534**	**-**	**(117,211)**	**135,660**
Loss for the period	-	-	-	-	-	(393)	(393)
Revaluation of available-for-sale investments	-	-	-	-	(68)	-	(68)
Total recognised income and expenses	-	-	-	-	-	-	(461)
Contribution from shareholders	-	-	-		-	8	8
Buy-out of own shares	-	(871)	-	-	-	969	98
Balance at 30 September 2008	**166,124**	**(871)**	**49,213**	**37,534**	**(68)**	**(116,627)**	**135,305**

General Director V.G. Yakovlev

Chief Accountant S.A. Suraev

23 December 2008

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

Note 1. The Group and its operations

(a) Organization and operations

The Open Joint Stock Company Mosenergo (the "Company") and its subsidiaries (together referred as the "Group" or the "Mosenergo Group") are primarily involved in generation of heat and electric power and heat distribution services in the Moscow city and Moscow region.

The Group's power and heat generation base includes 17 power stations with operational capacity equaled approximately 11,117.3 megawatts ("MW") and 34,297.4 gigacalories ("Gkal") of electricity and heat capacity, respectively.

OJSC Mosenergo was registered under the legislation of the Russian Federation on 6 April 1993 in accordance with State Property Management Committee Decree 169-R dated 26 March 1993 following the privatization process of electricity and heat power generation, transmission and distribution assets formerly under control of the Ministry of Energy of the Russian Federation.

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

(b) Group formation

On 1 April 2005 the Company was reorganized in form of spin-off following the reorganization process within Russian electricity sector aimed to introduce competition into the electricity market and to enable the companies of electricity sector to maintain and further expand production capacity. The Company's restructuring was approved by general shareholder's meeting on 28 June 2004. Before the restructuring took place the Company operated as integrated utility model, which included generation, transmission and distribution activities. As a result of the restructuring 13 new entities were separated from the Company and each shareholder of the Company received ordinary shares of each of the separated entities pro rata to Company's shares held by them prior to spin-off.

General shareholders' meeting held on 20 December 2006 approved closed subscription for the additional shares issued in favour of OJSC Gazprom and its affiliates (together referred as the "Gazprom Group"). As a result, the majority shareholder of OJSC Mosenergo has changed from RAO UES of Russia to Gazprom Group holding 53.47% of ordinary shares.

Following the reorganization process extraordinary general shareholder's meeting of RAO UES of Russia on 26 October 2007 decided to spin-off several holding companies to which shares in electricity generation companies, including Mosenergo, held by RAO UES of Russia, were transferred. Holdings separated from RAO UES of Russia were merged with generation companies by means of shares conversion, which enabled the shareholders of RAO UES of Russia to receive direct shares in generation companies after reorganization. Accordingly, upon spin-off from RAO UES of Russia OJSC Mosenergo Holding (the "Mosenergo Holding") received stake in Mosenergo held by RAO UES of Russia. Simultaneously with the spin-off Mosenergo Holding was merged with the Company and its shares were converted into the Company's shares.

(c) Business environment

The Russian Federation has been experiencing political and economic change that has affected, and may continue to affect, the activities of enterprises operating in this environment. Consequently, operations in the Russian Federation involve risks that typically do not exist in other markets. The consolidated interim financial statements reflect management's assessment of the impact of the Russian business environment on the operations and the financial position of the Group. The future business environment may differ from management's assessment.

(d) Relations with the state and current regulation

At the end of the reporting period the Russian Federation owned (both direct and indirect ownership) over 50% in OJSC Gazprom (the "parent"), which held 53.47% in the Company. Thus the Russian Federation is the ultimate controlling party of the Group.

The government of the Russian Federation directly affects the Group's operations through regulations of wholesale and retail sales of electricity and heat exercised by the Federal Service on Tariffs (the "FST") and the Regional Energy Commissions of Moscow and Moscow region (the "RECs"), respectively. OJSC "System Operator - Central Despatch Unit of Unified Energy System" (the "SO - CDU UES"), which is controlled by the Russian Federation, regulates operations of generating assets of the Group.

The Group's customer base as well as suppliers' chain includes a large number of entities controlled by or related to the state.

As described in Notes 6 and 31, the government's economic, social and other policies could materially effect operations of the Group.

Note 1. The Group and its operations (continued)

(e) Industry restructuring

Following Russian electric utility sector restructuring aimed to introduce competition to electricity (capacity) market the New Wholesale Electric Power (capacity) Market Rules of the Transitional Period (the "NOREM") approved by Resolution of the Government of the Russian Federation No. 529 dated 31 August 2006 were adopted. Under the new wholesale market framework, electricity and power purchases-sales transactions in the regulated market sector are to be governed by a regulated bilateral contract system. Starting 1 September 2006 regulated contracts covered all volumes of electricity and power produced and consumed.

Starting 2007, the volumes of electricity and power traded in the wholesale market applying regulated prices are reducing. The period from 2006 to 2011 is considered as the transition period. Upon the termination of transition period, organisation of electricity wholesale competitive market will be completed.

Note 2. Basis of preparation

(a) Statement of compliance

These consolidated interim financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs").

(b) Basis of measurement

The consolidated interim financial statements are prepared on the historical cost basis except that property, plant and equipment and investment property are revalued periodically; available-for-sale financial assets are measured at fair value; and the carrying amounts of equity items in existence at 31 December 2002 include adjustments for the effects of hyperinflation, which were calculated using conversion factors derived from the Russian Federation Consumer Price Index published by the Russian Statistics Agency, GosKomStat. Russia ceased to be hyperinflationary for IFRS purposes as at 1 January 2003.

The methods used to measure fair values are discussed further in Note 4.

(c) Functional and presentation currency

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

(d) Use of estimates and judgment

The preparation of financial statements in conformity with IFRSs requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ form these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

In particular, information about significant areas of estimation uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements is included in the following notes:

- Note 7 – Property, plant and equipment;
- Note 8 – Investment property;
- Note 17 – Employee benefits;
- Note 20– Provisions;

Note 3. Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these consolidated interim financial statements, and have been applied consistently by the Group entities.

Certain comparative amounts have been reclassified to conform with the current period's presentation. In addition, presentation of comparative statement of operations has been revised to present more detailed classification of expenses based on their nature to provide the users of the financial statements with more relevant information about the financial performance of the Group.

(a) Basis of consolidation

(i) Subsidiaries

Subsidiaries are entities controlled by the Group. Control exists when the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that currently are exercisable are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. The accounting policies of subsidiaries have been changed when necessary to align them with the policies adopted by the Group.

(ii) Associates (equity accounted investees)

Associates are those entities in which the Group has significant influence, but not control, over the financial and operating policies. Associates are accounted for using the equity method (equity accounted investees) and are recognised initially at cost. The Group's investment includes goodwill identified on acquisition, net of any accumulated impairment losses. The consolidated financial statements include the Group's share of the income and expenses and equity movements of equity accounted investees, after adjustments to align the accounting policies with those of the Group, from the date that significant influence commences until the date that significant influence ceases. When the Group's share of losses exceeds its interest in an equity accounted investee, the carrying amount of that interest (including any long-term investments) is reduced to nil and the recognition of further losses is discontinued except to the extent that the Group has an obligation or has made payments on behalf of the investee.

(iii) Transactions eliminated on consolidation

Intra-group balances and transactions, and any unrealised income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Unrealised gains arising from transactions with equity accounted investees are eliminated against the investment to the extent of the Group's interest in the investee. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

(b) Foreign currency transactions

Transactions in foreign currencies are translated to the respective functional currencies of Group entities at exchange rates at the dates of transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the exchange rate at the date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortised cost in foreign currency translated at the exchange rate at the end of the period. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate at the date that fair value was determined. Foreign currency differences arising on retranslation are recognised in profit or loss, except for differences arising on the retranslation of available-for-sale equity instruments.

(c) Financial instruments

(i) Non-derivative financial instruments

Non-derivative financial instruments comprise investments in equity and debt securities, trade and other receivables, cash and cash equivalents, loans and borrowings, and trade and other payables.

Non-derivative financial instruments are recognised initially at fair value plus, for instruments not at fair value through profit or loss, any directly attributable transaction costs. Subsequent to initial recognition non-derivative financial instruments are measured as described below.

Cash and cash equivalents comprise cash balances and call deposits. Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

Held-to-maturity investments

If the Group has the positive intent and ability to hold debt securities to maturity, then they are classified as held-to-maturity. Held-to-maturity investments are measured at amortised cost using the effective interest method, less any impairment losses.

Note 3. Significant accounting policies (continued)

Available-for-sale financial assets
The Group's investments in equity securities and certain debt securities are classified as available-for-sale financial assets. Subsequent to initial recognition, they are measured at fair value and changes therein, other than impairment losses, and foreign currency differences on available-for-sale monetary items, are recognised directly in equity. When an investment is derecognised, the cumulative gain or loss in equity is transferred to profit or loss.

Financial assets at fair value through profit or loss
An instrument is classified at fair value through profit or loss if it is held for trading or is designated as such upon initial recognition. Financial instruments are designated at fair value through profit or loss if the Group manages such investments and makes purchase and sale decisions based on their fair value in accordance with the Group's documented risk management or investment strategy. Upon initial recognition attributable transaction costs are recognised in profit or loss when incurred. Financial instruments at fair value through profit or loss are measured at fair value, and changes therein are recognised in profit or loss.

Other
Other non-derivative financial instruments are measured at amortised cost using the effective interest method, less any impairment losses.

(ii) Share capital
Ordinary shares
Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of ordinary shares and share options are recognised as a deduction from equity, net of any tax effects.

Repurchase of share capital (treasury shares)
When share capital recognised as equity is repurchased, the amount of the consideration paid, which includes directly attributable costs, is net of any tax effects, and is recognised as a deduction from equity. Repurchased shares are classified as treasury shares and are presented as a deduction from total equity. When treasury shares are sold or reissued subsequently, the amount received is recognised as an increase in equity, and the resulting surplus or deficit on the transaction is transferred to / from retained earnings.

(d) Property, plant and equipment

(i) Recognition and measurement
Until 31 December 2006, items of property, plant and equipment, except for land, were measured at cost less accumulated depreciation and impairment losses. The cost of property, plant and equipment at 31 December 1997, the date of transition to IFRSs, was determined by reference to its fair value at that date and subsequently restated to take into account the impact of inflation until 31 December 2002.

The Group changed its accounting policy to revaluing its property, plant and equipment starting from 1 January 2007 as management believes that it would provide the users of the financial statements with more relevant information about the financial position of the Group.

Property, plant and equipment are subject to revaluation on a regular basis to ensure that the carrying amount does not differ materially from that, which would be determined using fair value at the balance sheet date. Increase in the carrying amount of property, plant and equipment as a result of revaluation is credited directly to equity under the heading revaluation reserve, unless the decrease of the reserve was previously recognised in profit or loss. Decrease in the carrying amount shall be debited to equity to the extent of any credit balance existing in the revaluation reserve. Any accumulated depreciation at the date of revaluation is eliminated against the gross carrying amount of the asset, and the net amount is restated to the revalued amount of the asset.

The effects of taxes on income resulting from the revaluation of property, plant and equipment are charged directly to equity.

Cost of acquired assets includes expenditure that is directly attributable to the acquisition of the asset. The cost of self constructed assets includes the cost of materials, direct labour and any other costs directly attributable to bringing the asset to a working condition for its intended use, and the costs of dismantling and removing the items and restoring the site on which they are located. Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment.

(in millions of Russian Roubles)

Note 3. Significant accounting policies (continued)

Borrowing costs that are directly attributable to the acquisition, construction or production of an asset that necessarily takes a substantial period of time to get ready for its intended use or sale, are capitalised as part of the cost of that asset.

When parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment.

Gains and losses on disposal of an item of property, plant and equipment are recognised net in "other operating expenses" in profit or loss. When revalued assets are sold, the amounts included in the revaluation reserve are transferred to retained earnings.

(ii) Reclassification to investment property

Property that is being constructed for future use as investment property is accounted for as property, plant and equipment until construction or development is complete, at which time it is remeasured to fair value and reclassified to investment property. Any gain or loss arising on remeasurement is recognised in profit or loss.

When the use of property changes from owner-occupied to investment property, the property is remeasured to fair value and reclassified as investment property. Any gain arising on remeasurement is recognised in profit or loss to the extent the gain reverses previous impairment loss on a specific property, with any remaining gain recognised in the revaluation reserve directly in equity. Any loss is recognised in the revaluation reserve directly in equity to the extent that an amount is included in equity relating to a specific property, with any remaining loss recognised immediately in profit or loss.

(iii) Subsequent costs

The cost of replacing part of an item of property, plant and equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Group and its cost can be measured reliably. The carrying amount of the replaced part is derecognised. The costs of the day-to-day servicing of property, plant and equipment are recognised in the profit or loss as incurred.

(iv) Depreciation

Depreciation is recognised in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. Leased assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Group will obtain ownership by the end of lease term. Depreciation of an asset begins when it is available for use.

The estimated useful lives for the current and comparative periods are as follows:

• Production buildings	30-50 years
• Hydraulic constructions	15-25 years
• Other production constructions	11-35 years
• Plant and equipment of heat and power generation stations	15-35 years
• Plant and equipment of power substations	16-25 years
• Heating networks	7-20 years
• Other	15 years

Depreciation methods, useful lives and residual values are reviewed at each reporting date. Estimates in respect of useful lives of property, plant and equipment were revised in 2008 and became effective staring from 1 January 2008.

(e) Intangible assets

(i) Other intangible assets

Other intangible assets that are acquired by the Group, which have finite useful lives, are measured at cost less accumulated amortisation and accumulated impairment losses.

(ii) Subsequent expenditure

Subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure, including expenditure on internally generated goodwill and brands, is recognised in profit or loss as incurred.

Note 3. Significant accounting policies (continued)

(iii) Amortisation

Amortisation is recognised in profit or loss on a straight-line basis over the estimated useful lives of intangible assets, other than goodwill, from the date that they are available for use. The estimated useful lives for the current and comparative periods are as follows:

• patents and trademarks	10-20 years
• software	5-7 years

(f) Investment property

Investment property is property held either to earn rental income or for capital appreciation or for both, but not for sale in the ordinary course of business, use in the production or supply of goods or services or for administrative purposes. Investment property is measured at fair value with any change therein recognized in profit or loss.

When the use of a property changes such that it is reclassified as property, plant and equipment, its fair value at the date of reclassification becomes its cost for subsequent accounting.

(g) Leased assets

Leases in terms of which the Group assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

(h) Inventories

Inventories are measured at the lower of cost and net realizable value. The cost of inventories is based on the weighted average cost principle, and includes expenditure incurred in acquiring the inventories, production or conversion costs and other costs incurred in bringing them to their existing location and condition. In the case of manufactured inventories and work in progress, cost includes an appropriate share of production overheads based on normal operating capacity.

Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

(i) Impairment

(i) Financial assets

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount, and the present value of the estimated future cash flows discounted at the original effective interest rate. An impairment loss in respect of an available-for-sale financial asset is calculated by reference to its fair value.

Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognised in profit or loss. Any cumulative loss in respect of an available-for-sale financial asset recognised previously in equity is transferred to profit or loss.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognised. For financial assets measured at amortised cost and available-for-sale financial assets that are debt securities, the reversal is recognised in profit or loss. For available-for-sale financial assets that are equity securities, the reversal is recognised directly in equity.

(ii) Non-financial assets

The carrying amounts of the Group's non-financial assets, other than investment property, inventories and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. For goodwill and intangible assets that have indefinite lives or that are not yet available for use, the recoverable amount is estimated each year at the same time.

Note 3. Significant accounting policies (continued)

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the "cash-generating unit"). The goodwill acquired in a business combination, for the purpose of impairment testing, is allocated to cash-generating units that are expected to benefit from the synergies of the combination.

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its estimated recoverable amount. Impairment losses are recognised in profit or loss. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amounts of the other assets in the unit (group of units) on a pro rata basis.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

(j) Employee benefits

(i) Defined benefit plans

A defined benefit plan is a post-employment benefit plan other than a defined contribution plan. The Group's net obligation in respect of defined benefit pension plans is calculated separately for each plan by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods; that benefit is discounted to determine its present value. Any unrecognised past service costs and the fair value of any plan assets are deducted. The discount rate is the yield at the reporting date on AA credit-rated bonds that have maturity dates approximating the terms of the Group's obligations and that are denominated in the same currency in which the benefits are expected to be paid. The calculation is performed annually by a qualified actuary using the projected unit credit method. When the calculation results in a benefit to the Group, the recognised asset is limited to the total of any unrecognised past service costs and the present value of economic benefits available in the form of any future refunds from the plan or reductions in future contributions to the plan. An economic benefit is available to the Group if it is realisable during the life of the plan, or on settlement of the plan liabilities.

When the benefits of a plan are improved, the portion of the increased benefit relating to past service by employees is recognised in profit or loss on a straight-line basis over the average period until the benefits become vested. To the extent that the benefits vest immediately, the expense is recognised immediately in profit or loss.

(ii) Other long-term employee benefits

The Group's net obligation in respect of long-term employee benefits other than pension plans is the amount of future benefit that employees have earned in return for their service in the current and prior periods; that benefit is discounted to determine its present value, and the fair value of any related assets is deducted. The discount rate is the yield at the reporting date on AA credit-rated bonds that have maturity dates approximating the terms of the Group's obligations. The calculation is performed using the projected unit credit method. Any actuarial gains or losses are recognised in profit or loss in the period in which they arise.

(iii) Termination benefits

Termination benefits are recognised as an expense when the Group is demonstrably committed, without realistic possibility of withdrawal, to a formal detailed plan to either terminate employment before the normal retirement date, or to provide termination benefits as a result of an offer made to encourage voluntary redundancy. Termination benefits for voluntary redundancies are recognised as an expense if the Group has made an offer of voluntary redundancy, it is probable that the offer will be accepted, and the number of acceptances can be estimated reliably.

(vi) Short-term benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided.

A liability is recognised for the amount expected to be paid under short-term cash bonus or profit-sharing plans if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

Note 3. Significant accounting policies (continued)

(k) Provisions

A provision is recognised if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability.

(l) Revenues

(i) Goods sold

Revenues from sales of electricity and heat are recognised when electricity and heat are delivered to customers.

Revenue from the sale of goods other than electricity and heat is measured at the fair value of the consideration received or receivable, net of returns, trade discounts and volume rebates. Revenue is recognised when the significant risks and rewards of ownership have been transferred to the buyer, recovery of the consideration is probable, the associated costs and possible return of goods can be estimated reliably, there is no continuing management involvement with the goods, and the amount of revenue can be measured reliably. Transfers of risks and rewards vary depending on the individual terms of the contract of sale.

(ii) Services

Revenue from services rendered is recognised in profit or loss in proportion to the stage of completion of the transaction at the reporting date. The stage of completion is assessed by reference to surveys of work performed.

(iii) Rental income

Rental income from investment property is recognised in profit or loss on a straight-line basis over the term of the lease. Lease incentives granted are recognised as an integral part of the total rental income, over the term of the lease.

(m) Government grants

An unconditional government grants are recognised in profit or loss when the grant becomes receivable.

Other government grants are recognised initially as deferred income when there is reasonable assurance that they will be received and the Group will comply with the conditions associated with the grant. Grants that compensate the Group for expenses incurred are recognised in profit or loss on a systematic basis in the same periods in which the expenses are recognised. Grants that compensate the Group for the cost of an asset are recognised in profit or loss on a systematic basis over the useful life of the asset.

(n) Lease payments

Payments made under operating leases are recognised in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognised as an integral part of the total lease expense, over the term of the lease.

Minimum lease payments made under finance leases are apportioned between the finance expense and the reduction of the outstanding liability. The finance expense is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Contingent lease payments are accounted for by revising the minimum lease payments over the remaining term of the lease when the lease adjustment is confirmed.

(o) Financial income and expenses

Financial income comprises interest income on funds invested (including available-for-sale financial assets), dividend income, gains on the disposal of available-for-sale financial assets and changes in the fair value of financial assets at fair value through profit or loss. Interest income is recognised as it accrues in profit or loss, using the effective interest method. Dividend income is recognised in profit or loss on the date that the Group's right to receive payment is established, which in the case of quoted securities is the ex-dividend date.

Financial expenses comprise interest expense on borrowings, unwinding of the discount on provisions, changes in the fair value of financial assets at fair value through profit or loss and impairment losses recognised on financial assets. All borrowing costs are recognised in profit or loss using the effective interest method.

Foreign currency gains and losses are reported on gross basis.

(p) Income tax

Income tax expense comprises current and deferred tax. Income tax expense is recognised in profit or loss except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Note 3. Significant accounting policies (continued)

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognised using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for the following temporary differences: the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss, and differences relating to investments in subsidiaries to the extent that it is probable that they will not reverse in the foreseeable future. In addition, deferred tax is not recognised for taxable temporary differences arising on the initial recognition of goodwill. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realised simultaneously.

A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

(q) Earnings per share

The Group presents basic and diluted earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares outstanding during the period. Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, which comprise convertible notes and share options granted to employees.

(r) 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 and Moscow region. 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.

(s) New Standards and Interpretations not yet adopted

The following new Standards, amendments to Standards and Interpretations are not yet effective as at 30 September 2008, and have not been applied in preparing these consolidated interim financial statements. The Group plans to adopt these pronouncements when they become effective.

- IFRS 8 *Operating Segments* introduces the "management approach" to segment reporting. IFRS 8 *Operating Segments*, which becomes mandatory for the Group's 2009 financial statements, will require the disclosure of segment information based on the internal reports regularly reviewed by the Group's Chief Operating Decision Maker in order to assess each segment's performance and to allocate resources to them. Currently the Group does not present segment information in respect of its business and geographical segments as operated in one geographical and business segments (see Note 3 (r)). The new Standard will not have any impact on the Group's financial position or performance.

- Revised IAS 1 *Presentation of Financial Statements (2007)* which becomes mandatory for the Group's 2009 consolidated financial statements is expected to have a significant impact on the presentation of the consolidated financial statements. The Standard introduces the concept of total comprehensive income and requires presentation of all owner changes in equity in the statement of changes in equity, separately from non-owner changes in equity.

- Revised IAS 23 *Borrowing Costs* removes the option to expense borrowing costs and requires that an entity capitalise borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. In accordance with the transitional provisions the Group will apply the revised IAS 23 to qualifying assets for which capitalisation of borrowing costs commences on or after the effective date. The amendments to IAS 23, which become mandatory for the Group's 2009 consolidated financial statements, are not expected to have a significant impact on the consolidated financial statements.