

TRANSGAZ SA

**FINANCIAL STATEMENTS
FOR THE YEAR ENDED
31 DECEMBER 2005**

**PREPARED IN ACCORDANCE WITH
INTERNATIONAL FINANCIAL REPORTING
STANDARDS**

TRANSGAZ SA

FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2005

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GENERAL INFORMATION

Description of the business

The National Company for Transportation of Natural Gas - SNTGN Transgaz SA ("the Company") is a state owned company involved in the transportation and sale of natural gas.

Establishment of the Company

In accordance with Government Decision No 334 published on 4 May 2000, the gas sector in Romania was reorganized. The shares held by the former Romgaz SA in its subsidiaries were transferred to the Ministry of Industry and Trade and, as a consequence, the following independent companies were established:

- Transgaz SA, in charge with the transportation of natural gas from the producers to the distribution companies, the successor entity of Romgaz SA;
- Exprogaz SA, a natural gas exploration, production and storage company, incorporating the activities of the former Exprogaz Medias and Exprogaz Targu Mures;
- Depogaz SA, a natural gas exploration, production and storage company, the successor entity of Exprogaz Ploiesti SA;
- Distrigaz Nord SA, a gas distribution company covering the northern half of the country;
- Distrigaz Sud SA, a gas distribution company covering the southern half of the country.

The Romanian Gas Industry was further re-organized through Government Decision No 575 published on 27 June 2001. According to this decision, SNGN Romgaz SA was established through the merger of Exprogaz SA Mediaş and Depogaz SA Ploieşti.

Information on the natural gas sector

The downstream gas activities are regulated by the National Agency for Regulation of the Natural Gas Sector ("Agenția Națională pentru Reglementare în Domeniul Gazelor Naturale" - ANRGN) which was incorporated through the Government Ordinances 60/2000 and 41/2000. The main responsibilities of ANRGN are the following:

- issuance or withdrawal of licenses for companies operating in the natural gas sector;
- publication of framework contracts for sale, transport, acquisition and distribution to end users of natural gas;
- setting criteria, requirements and procedures related to the selection of eligible customers;
- setting pricing criteria and computation methods for the natural gas sector.

GENERAL INFORMATION

Description of the business (continued)

In view of the EU accession agreements concluded by Romania, ANRGN coordinates an internal gas market liberalization process to be completed by 2007. The main stages of the process are the following:

2005: extension of the market liberalization to 50%;
2006: extension of the market liberalization to 75%;
2007: extension of the market liberalization to 100%.

Privatisation strategy in the gas sector

In March 2005 the Government published the strategy for accelerating the privatisation process and attracting investments for the companies owned by the Ministry of Economy and Commerce (Government Decision 184/March 2005). For Transgaz, the strategy includes:

- initiating the process of a primary public listing on the capital markets of a stake of 15% of the Company's shares;
- transfer a stake in the Company to the "Proprietatea" fund as restitution of property according to Law 10/2001.

Statutory information of the Company

The registered office of the Company is I.C. Motas Square Nr 1, Medias, Romania.

The sole shareholder of the Company as at 31 December 2004 and 31 December 2005 was Romanian State represented by the Ministry of Economy and Commerce (the former Ministry of Industries and Resources).

During 2005, based on Law 247/2005 the Ministry of Economy and Commerce participated to the establishment of "Proprietatea" Fund which was set up by transfer of shares held by the State. Based on this Law, in December 2005 15% of the Company's share capital held by Ministry of Economy and Commerce were transferred to "Proprietatea" Fund but the transfer of shares and recording of the changes in the shareholders' structure had not been completed by the date of the approval of the Financial statements.

Employees

The average number of employees for the years ended 31 December 2005 and 31 December 2004 was 4,759 and 4,674 respectively.

GENERAL INFORMATION

Nature of operations

Transgaz SA is involved in the following activities:

- transportation and dispatch of natural gas, which is the core activity of the Company;
- operation of the national gas transportation system;
- import and re-sale of natural gas;
- international transit of natural gas;
- research and design in the field of equipment for the natural gas industry.

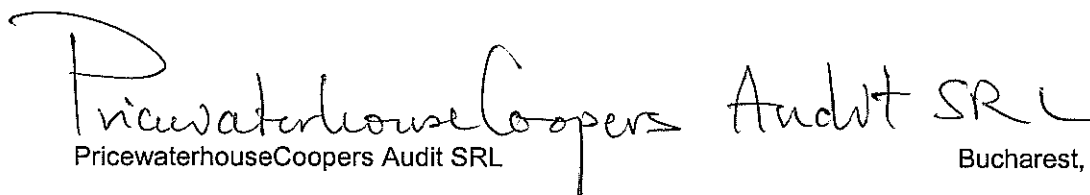
Management structure

The persons who served office during the year were the following:

Position	Name	Period
General Manager	Cocone Gabriel	1 January 2005- 21 March 2005
General Manager	Muntean Florin	31 March 2005-31 December 2005
Economic Deputy General Manager	Goage Laurentia	1 January 2005 – 31 December 2005
Technical Deputy General Manager	Pintican Juga LTraian	1 January 2005 – 31 December 2005

REPORT OF THE INDEPENDENT AUDITORS TO THE BOARD OF DIRECTORS OF TRANSGAZ SA

- 1 We have audited the accompanying balance sheet of Transgaz SA (the "Company") as of 31 December 2005 and the related statements of income, of cash flows and of changes in shareholders equity for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.
- 2 Except as presented in paragraph 3, 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinion.
- 3 As discussed in note 7 to these financial statements, due to the lack of audited financial information prepared in accordance with International Financial Reporting Standards for an investment controlled by the Company, the respective investment is recorded at impaired cost. In our opinion, this practice is not in accordance with the requirements of IAS 27 "Consolidated and Separate Financial Statements", which prescribes that investments in subsidiaries should be consolidated.
- 4 In our opinion, except for the effect of such adjustments as might have been determined to be necessary had we been able to satisfy ourselves as to the matters described in paragraph 3, the financial statements present fairly, in all material respects, the financial position of the Company as of 31 December 2005, and the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.


PricewaterhouseCoopers Audit SRL

Bucharest, 27 April 2006

TRANSGAZ SA

BALANCE SHEET

(Expressed in RON thousand, unless otherwise stated)

	<u>Note</u>	<u>31 December 2005</u>	<u>31 December 2004</u>
ASSETS			
Non-current assets			
Intangible fixed assets	6	10,549	11,499
Property, plant and equipment	5	2,602,485	2,521,865
Available for sale financial assets	7	<u>1,160</u>	<u>1,159</u>
		2,614,194	2,534,523
Current assets			
Inventories	8	37,559	40,117
Trade and other receivables	9	151,159	132,626
Cash and cash equivalents	10	<u>66,186</u>	<u>54,794</u>
		254,904	227,537
Total assets		<u>2,869,098</u>	<u>2,762,060</u>
EQUITY AND LIABILITIES			
Shareholders' equity			
Share capital	11	545,222	545,123
Public property reserve	12	1,265,797	1,265,797
Retained earnings		<u>387,855</u>	<u>350,450</u>
		2,198,874	2,161,370
Non-current liabilities			
Long term borrowings	13	186,345	200,845
Long term tax and other state payables	15	-	2,155
Provision for liabilities and charges	19	11,278	10,443
Deferred income	14	15,895	7,730
Deferred tax liability	16	<u>147,488</u>	<u>164,458</u>
		361,007	385,633
Current liabilities			
Trade and other payables	17	210,052	107,247
Current income tax liabilities		4,110	21,958
Short term borrowings	18	82,087	73,381
Provision for liabilities and charges	19	<u>12,969</u>	<u>12,474</u>
		309,218	215,060
Total liabilities		<u>670,224</u>	<u>600,690</u>
Total equity and liabilities		<u>2,869,098</u>	<u>2,762,060</u>

These financial statements have been approved for issue by the Board of Directors on 27 April 2006.

(Florin Muntean
General Manager



Laurentia Goage
Deputy General Manager

The accompanying notes 1 to 20 are an integral part of these financial statements.

(Signature)
(1)

TRANSGAZ SA

INCOME STATEMENT

(Expressed in RON thousand, unless otherwise stated)

	Note	Year ended 31 December 2005	Year ended 31 December 2004
Revenue	20	767,188	768,777
Other income	21	<u>13,377</u>	<u>5,427</u>
		780,565	774,204
Cost of gas sold		(36,554)	(89,415)
Depreciation and amortisation	5; 6	(161,203)	(154,524)
Provision for impairment of property, plant and equipment	5; 6	-	(18,302)
Wages and salaries		(141,318)	(124,418)
Gas, materials and consumables used		(176,868)	(137,131)
Royalty expense		(35,851)	(33,854)
(Provision)/Release of provision for impairment of current assets	8,9	(4,099)	14,597
Provision for liabilities and charges		(1,331)	(13,800)
Taxes and other state dues		(2,986)	(2,940)
Other operating expenses	22	<u>(82,228)</u>	<u>(54,793)</u>
Operating profit		138,127	159,624
Financial income	23	12,925	33,693
Financial expense	23	<u>(35,274)</u>	<u>(24,481)</u>
Profit before taxation		115,778	168,836
Taxation	16	<u>(19,774)</u>	<u>55,224</u>
Net profit for the period		<u>96,004</u>	<u>224,060</u>

These financial statements have been approved for issue by the Board of Directors on 27 April 2006.

(Florin Muntean
General Manager



Laurentia Goage
Deputy General Manager

The accompanying notes 1 to 29 form an integral part of these financial statements.

TRANSGAZ SA

STATEMENT OF CHANGES IN THE SHAREHOLDERS' EQUITY

FOR THE YEAR ENDED 31 DECEMBER 2005

(Expressed in RON thousand, unless otherwise stated)

	<u>Note</u>	<u>Share capital</u>	<u>Public property reserve</u>	<u>Retained earnings</u>	<u>Total equity</u>
Balance at 31 December 2003					
as reported		545,049	1,265,797	144,386	1,955,232
Correction of prior period's errors		-	-	(7,658)	(7,658)
Balance as 1 January 2004 as restated		545,049	1,265,797	136,728	1,947,574
Share capital increase		74	-	-	74
Profit for the year as restated		-	-	224,060	224,060
Tax and other charges on distributions ¹⁾		-	-	(10,338)	(10,338)
Balance at					
31 December 2004 as restated		545,123	1,265,797	350,450	2,161,370
Balance at 1 January 2005					
Share capital increase	11	99	-	-	99
Profit for the year		-	-	96,004	96,004
Tax and other charges on distributions ¹⁾		-	-	(9,116)	(9,116)
Dividends referring to 2002 previously retained		-	-	(4,000)	(4,000)
Additional distribution decided by Shareholder ²⁾		-	-	(45,483)	(45,483)
Balance 31 December 2005		<u>545,222</u>	<u>1,265,797</u>	<u>387,855</u>	<u>2,198,874</u>

Share capital includes an adjustment for inflation as detailed also in Note 2.2. This is shown separately in Note 11 together with the movements in the statutory value of share capital.

1) As at 31 December 2004 and 31 December 2005, the Company had distributed dividends of RON 91,156 and RON 78,238 respectively towards the sole shareholder. According to the provisions of the Emergency Government Ordinance 137/December 2004 (note 3.10), the Company is entitled to retain the respective dividends (net of relating tax). The Statement of Changes in Equity presents only the net movement which corresponds to the taxation of the distributed dividends.

2) The Ministry of Economy and Commerce, as sole shareholder of Transgaz, has decided to require the Company an additional distribution in relation to the dividends declared and unpaid during the period 2000-2003, which management had decided to retain in the Company based on their interpretation of existing legislation. Given the substance of this additional distribution, the Company's management decided to record and present them as a movement in retained earnings.

The accompanying notes 1 to 29 form an integral part of these financial statements.

TRANSGAZ SA

CASH FLOW STATEMENT

(Expressed in RON thousand, unless otherwise stated)

	<u>Note</u>	<u>Year ended</u> <u>31 December 2005</u>	<u>Year ended</u> <u>31 December 2004</u>
Cash generated from operations	24	314,827	417,331
Interest paid, net		(13,813)	(12,769)
Dividends paid		-	(32,960)
Income taxes paid		<u>(54,592)</u>	<u>(65,314)</u>
Net cash inflow from operating activity		246,422	306,288
Cash flow from investment activities			
Payments to acquire property, plant and equipment		(223,228)	(277,550)
Proceeds from disposal of property plant and equipment		(7,743)	(6,371)
Dividends received		32	8
Acquisition of investments		<u>1</u>	<u>(233)</u>
Net cash used in investment activities		(230,938)	(284,145)
Cash flow from financing activities			
Proceeds from long term borrowings		6,562	9,937
Repayments of long term borrowings		<u>(13,849)</u>	<u>(47,372)</u>
Net cash used in financing activities		(7,287)	(37,435)
Effect of exchange rate changes		-	(2,779)
Net charge in cash and cash equivalents		8,197	(18,071)
Cash and cash equivalents at the beginning of the year	10	<u>24,841</u>	<u>42,912</u>
Cash and cash equivalents at the end of the year	10	<u>33,038</u>	<u>24,841</u>

The accompanying notes 1 to 29 form an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2005

(Expressed in RON thousand, unless otherwise stated)

1 REPORTING ENTITY

These financial statements are presented by TRANSGAZ SA (the "Company").

2 BASIS OF PRESENTATION OF THE FINANCIAL STATEMENTS

2.1 Basis of preparation

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB"). They are not the statutory accounts of the Company. The Company has prepared IFRS financial statements since 2001 and is not a first time adopter of IFRS.

The Company maintains its accounting records in RON and prepares its statutory financial statements in accordance with the Regulations on Accounting and Reporting of Romania. The financial statements are based on the statutory records, with adjustments and reclassifications recorded for the purpose of fair presentation in accordance with IFRS.

The financial statements have been prepared using the historical cost convention, except as disclosed in the accounting policies below.

The preparation of financial statements in conformity with IFRS requires the use certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Company's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in Note 4.

(a) Adoption of new and revised standards and interpretations

The following amendments and interpretations to standards are mandatory for the Company's accounting periods beginning on or after 1 January 2005:

- IAS 1 (revised 2003), Presentation of Financial Statements (effective from 1 January 2005);
- IAS 16 (revised 2003) Property, Plant and Equipment (effective from 1 January 2005);
- IAS 17 (revised 2003) Leases (effective from 1 January 2005);
- IAS 21 (revised 2003) The Effects of Changes in Foreign Exchange Rates (effective from 1 January 2005);
- IAS 24 (revised 2003) Related Party Disclosures (effective from 1 January 2005);

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2005

(Expressed in RON thousand, unless otherwise stated)

2 BASIS OF PRESENTATION OF THE FINANCIAL STATEMENTS (CONTINUED)

- IAS 27 Consolidated and Separate Financial Statements (effective from 1 January 2005);
- IAS 28 (revised 2003) Investments in Associates (effective from 1 January 2005);
- IAS 32 (revised 2003) Financial Instruments: Disclosure and Presentation (effective from 1 January 2005);
- IAS 36 (revised 2004) Impairment of Assets (effective from 1 January 2005);
- IAS 38 (revised 2004) Intangible Assets (effective from 31 March 2004);
- IAS 39 (revised 2003) Financial Instruments: Recognition and Measurement (effective from 1 January 2005);
- IFRS 3 (issued 2004) Business Combinations (effective from 31 March 2004);
- IFRS 5 (issued 2004) Non-current Assets Held for Sale and Discontinued Operations (effective from 1 January 2005);
- IFRIC 2, Members' Shares in Co-operative Entities and Similar Instruments (effective from 1 January 2005); and
- IAS 39 (Amendment), Transition and Initial Recognition of Financial Assets and Financial Liabilities (effective from 1 January 2005).

The management assessed the relevance of these amendments and interpretations with respect to the Company's operations and concluded that, except for IAS 24 (revised 2003), which resulted in additional disclosures (Note 24), they are either not relevant to the Company or do not significantly affect the Company's financial statements.

(b) **New accounting pronouncements**

Certain new standards and interpretations have been published that are mandatory for the Company's accounting periods beginning on or after 1 January 2006 or later periods and which the entity has not early adopted:

IAS 39 (Amendment) – The Fair Value Option (effective from 1 January 2006)

IAS 39 (as revised in 2003) permitted entities to designate irrevocably on initial recognition practically any financial instrument as one to be measured at fair value with gains and losses recognised in profit or loss ('fair value through profit or loss'). The amendment changes the definition of financial instruments 'at fair value through profit or loss' and restricts the ability to designate financial instruments as part of this category. The Company's policy is not to voluntarily designate assets and liabilities as at fair value through profit or loss.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2005

(Expressed in RON thousand, unless otherwise stated)

2 BASIS OF PRESENTATION OF THE FINANCIAL STATEMENTS (CONTINUED)

IAS 39 (Amendment) - Cash Flow Hedge Accounting of Forecast Intragroup Transactions (effective from 1 January 2006)

The amendment allows the foreign currency risk of a highly probable forecast intragroup transaction to qualify as a hedged item in the financial statements provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and the foreign currency risk will affect profit or loss. This amendment is not relevant to the Company's operations, as the Company does not have any intragroup transactions that would qualify as a hedged item in the financial statements as of 31 December 2005 and 2004.

IAS 39 (Amendment) – Financial Guarantee Contracts (effective from 1 January 2006)

Issued financial guarantees, other than those previously asserted by the entity to be insurance contracts, will have to be initially recognised at their fair value, and subsequently measured at the higher of (i) the unamortised balance of the related fees received and deferred and (ii) the expenditure required to settle the commitment at the balance sheet date. Different requirements apply for the subsequent measurement of issued financial guarantees that prevent derecognition of financial assets or result in continuing involvement accounting. Management considered this amendment to IAS 39 and concluded that it is not relevant to the Company.

IFRS 7 Financial Instruments: Disclosures and a complementary Amendment to IAS 1 Presentation of Financial Statements - Capital Disclosures (effective from 1 January 2007)

The IFRS introduces new disclosures to improve the information about financial instruments. Specifically, it requires disclosure of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk including sensitivity analysis to market risk. It replaces some of the requirements in IAS 32, Financial Instruments: Disclosure and Presentation. The Amendment to IAS 1 introduces disclosures about level of an entity's capital and how it manages capital. The Company assessed the impact of IFRS 7 and the amendment to IAS 1 and concluded that the main additional disclosures will be the sensitivity analysis to market risk and the capital disclosures required by the amendment of IAS 1. The Company will apply IFRS 7 and the amendment to IAS 1 from annual periods beginning 1 January 2007.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2005

(Expressed in RON thousand, unless otherwise stated)

2 BASIS OF PRESENTATION OF THE FINANCIAL STATEMENTS (CONTINUED)

IAS 19 (Amendment) - Employee Benefits (effective from 1 January 2006)

The amendment to IAS 19 introduces an additional option to recognise actuarial gains and losses arising in post-employment defined benefit plans in full directly in retained earnings in equity. It also requires new disclosures about defined benefit plans and clarifies accounting for a contractual agreement between a multi-employer plan and participating employers. As the Company does not participate in any multi-employer plans and does not maintain any pension plan for any of its employees (which is in accordance with the legislation in various countries where it operates) the adoption of this amendment will have no impact on its financial statements

IFRIC 4, Determining whether an Arrangement contains a Lease (effective from 1 January 2006)

IFRIC 4 requires that determining whether an arrangement is, or contains, a lease be based on the substance of the arrangement. It requires an assessment of whether (a) fulfilment of the arrangement is dependent on the use of a specific asset or assets (the asset); and (b) the arrangement conveys a right to use the asset. Management has assessed the impact of IFRIC 4 on the Company's operations and concluded that it is not relevant to the Company.

IFRIC 6, Liabilities arising from Participating in a Specific Market - Waste Electrical and Electronic Equipment (effective for periods beginning on or after 1 December 2005 that is from 1 January 2006)

The Interpretation states that a liability shared among market participants in proportion to their respective market share, in particular the liability for the decommissioning of historical waste electrical and electronic equipment in the European Union, should not be recognised because participation in the market during the measurement period is the obligating event in accordance with IAS 37. The Company will apply IFRIC 6 from annual periods beginning 1 January 2006.

IFRIC 7, Applying the Restatement Approach under IAS 29 (effective for periods beginning on or after 1 March 2006, that is from 1 January 2007)

The Interpretation clarifies application of IAS 29 in the reporting period in which hyperinflation is first identified. It states that IAS 29 should initially be applied as if the economy has always been hyperinflationary. It further clarifies calculation of deferred income taxes in the opening balance sheet restated for hyperinflation in accordance with IAS 29. As the country where the Company operates is no longer hyperinflationary, IFRIC 7 is not relevant to the Company.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2005

(Expressed in RON thousand, unless otherwise stated)

2 BASIS OF PRESENTATION OF THE FINANCIAL STATEMENTS (CONTINUED)

IFRIC 8, Scope of IFRS 2 (effective for periods beginning on or after 1 May 2006, that is from 1 January 2007)

The interpretation states that IFRS 2 also applies to transactions in which the entity receives unidentifiable goods or services and that such items should be measured as the difference between the fair value of the share-based payment and the fair value of any identifiable goods or services received (or to be received). IFRIC 8 is not relevant to the Company's operations.

IAS 21 (Amendment) - Net Investment in a Foreign Operation (effective from 1 January 2006)

This amendment requires foreign exchange gains and losses on quasi-equity intercompany loans to be reported in consolidated equity even if the loans are not in the functional currency of either the lender or the borrower. Currently, such exchange differences are required to be recognised in consolidated profit or loss. It also extends the definition of 'net investment in a foreign operation' to include loans between sister companies. This amendment to IAS 21 is not relevant to the Company's operations.

IFRS 1 (Amendment) - First-time Adoption of International Financial Reporting Standards and IFRS 6 Exploration for and Evaluation of Mineral Resources (effective from 1 January 2006)

This minor amendment to IFRS 1 clarifies that the IFRS 6 comparative information exemption applies to the recognition and measurement requirements of IFRS 6, as well as the disclosure requirements. This amendment is not relevant to the Company's operations.

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

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

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2005

(Expressed in RON thousand, unless otherwise stated)

2 BASIS OF PRESENTATION OF THE FINANCIAL STATEMENTS (CONTINUED)*2.2 Accounting for the effect of hyperinflation*

Romania has previously experienced relatively high levels of inflation and was considered to be hyperinflationary as defined by IAS 29 "Financial Reporting in Hyperinflationary Economies" ("IAS 29"). IAS 29 requires that the financial statements prepared in the currency of a hyperinflationary economy be stated in terms of the measuring unit current at the balance sheet date. As the characteristics of the economic environment of Romania indicate that hyperinflation has ceased, effective from 1 January 2004 the Company no longer applies the provisions of IAS 29. Accordingly, the amounts expressed in the measuring unit current at 31 December 2003 are treated as the basis for the carrying amounts in these financial statements.

The restatement was calculated using the conversion factors derived from the Romanian Consumer Price Index ("CPI"), published by the Comisia Nationala de Statistica. The indices used to restate corresponding figures, based on 1998 prices (1998 = 100) for the five years ended 31 December 2003, and the respective conversion factors are:

<u>Year</u>	<u>Movement in CPI</u>	<u>Indices</u>	<u>Conversion Factor</u>
1999	54.8%	1.548	2.46
2000	40.7%	2.178	1.75
2001	30.3%	2.838	1.35
2002	17.8%	3.343	1.14
2003	14.1%	3.815	1

2.3 Correction of prior period errors

As described in note 19, during year ended 31 December 2005, the Company has estimated the present value of future obligations payable to its employees at the time of the retirement in accordance with the collective labour contract. The Company has recognized a provision for retirement benefits within the financial statements for the year ended 31 December 2005. The financial statements for the year ended 31 December 2004 did not include a similar provision. Therefore, in accordance with the requirements of IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors", the Company has corrected the error retrospectively, by restating the comparatives.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2005

(Expressed in RON thousand, unless otherwise stated)

2 BASIS OF PRESENTATION OF THE FINANCIAL STATEMENTS (CONTINUED)

The effect of the restatement on the comparatives financial statements is summarised below.

	Effect on fiscal 2004
<i>Income statement</i>	
(Increase) in expense with provision for risks and charges	(1,325)
Increase in deferred tax income	<u>212</u>
(Decrease) in profit for the period	<u>(1,113)</u>
<i>Balance sheet</i>	
(Increase) in provision for risk and charges	(10,442)
Decrease in deferred tax liability	1,671
Decrease in equity (opening reserves)	<u>7,658</u>
(Decrease) in retained earnings	<u>(1,113)</u>

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

3.1 Intangible assets

Research and development

Research expenditure is recognized as an expense as incurred. Costs incurred on development projects (relating to the design and testing of new or improved services) are recognized as intangible assets to the extent that such expenditure is expected to generate future economic benefits. Other development expenditures are recognized as an expense as incurred. Development costs previously recognized as an expense are not recognized as an asset in a subsequent period. Development costs that have been capitalized are amortized from the commencement of the commercial production of the product on a straight-line basis over the period of its expected benefit. The amortization periods adopted do not exceed five years.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2005

(Expressed in RON thousand, unless otherwise stated)

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Computer software

Acquired computer software licenses are capitalized on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortized over their estimated useful lives (three years). Costs associated with developing or maintaining computer software are recognized as an expense as incurred.

3.2 Property, plant and equipment

Property, plant and equipment are stated at cost, restated to the equivalent purchasing power of the Romanian Leu at 31 December 2003 for assets acquired prior to 1 January 2004, less accumulated depreciation and provision for impairment, where required.

Items acquired after 1 January 2004 are stated at cost less accumulated depreciation and provision for impairment, where required.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

Assets in course of construction are capitalized and will be depreciated over the useful life of the asset, from the date of commissioning.

Depreciation is calculated on the restated amounts of property, plant and equipment on a straight-line basis down to the assets' residual values.

The depreciation periods, which represent to the estimated useful economic lives of the respective assets, are as follows:

	<u>Years</u>
Buildings	50
Assets in the gas transportation system	20 - 50
Other fixed assets	5 - 20

Land and assets in course of construction are not depreciated.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2005

(Expressed in RON thousand, unless otherwise stated)

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (Note 3.3).

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the income statement.

3.3 Impairment of non-financial assets

Assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. An impairment loss recognised for an asset in prior years is reversed if there has been a change in the circumstances, which led to the impairment. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

3.4 Public property assets

In accordance with the Public Property Law 213/1998, gas transportation pipelines represent state property. Government Decision 491/1998, as confirmed in Government Decision 334/2000, specifies that fixed assets with a statutory gross book value of RON 499,726 (restated net book value of RON 740,310 at 31 December 2005) representing gas pipelines are to be administered by the Company. Therefore, the Company has the exclusive right to use these assets over the concession period (see below). The Company receives the majority of the benefits associated with the assets and is exposed to the majority of risks, including the requirement to maintain the network assets over a period which is at least equal to their remaining useful life, and the Company's financial performance is directly linked to the condition of the network system. Consequently, the Company has recognized these assets in its balance sheet, together with a corresponding reserve in equity.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2005

(Expressed in RON thousand, unless otherwise stated)

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

As per the Public Concession Law 219/1998, a royalty must be paid in respect of public property assets which are administered by companies other than state bodies. In accordance with the Concession Agreement signed by the Company with the National Agency for Mineral Resources ("ANRM") in May 2002 (the "Concession Agreement") and approved by the Government Decision 668 /20 June 2002, the royalty to be paid in respect of public property assets has been set for the period 2002 – 2006 at the level of 5% of the revenues from gas transportation and transit. The level of the royalty is to be revised after 2006. The duration of the concession agreement is of 30 years.

3.5 Financial assets

The Company classifies its financial assets in the following categories: at fair value through profit or loss, loans and receivables, and available for sale. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition and re-evaluates this designation at every reporting date.

(a) *Financial assets at fair value through profit or loss*

This category has two sub-categories: financial assets held for trading, and those designated at fair value through profit or loss at inception. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management. Derivatives are also categorised as held for trading unless they are designated as hedges. Assets in this category are classified as current assets if they are either held for trading or are expected to be realised within 12 months of the balance sheet date. During the period the Company did not hold any trading or fair value through profit or loss financial assets.

(b) *Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the balance sheet date. These are classified as non-current assets. Loans and receivables are classified as 'trade and other receivables' in the balance sheet (Note 3.7).

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2005

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3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(c) *Available-for-sale financial assets*

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the balance sheet date.

Regular purchases and sales of investments are recognised on trade-date – the date on which the Company commits to purchase or sell the asset. Investments are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss.

Financial assets carried at fair value through profit or loss are initially recognised at fair value and transaction costs are expensed in the income statement. Investments are derecognised when the rights to receive cash flows from the investments have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership. Available for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables and held-to-maturity investments are carried at amortised cost using the effective interest method.

Gains or losses arising from changes in the fair value of the 'financial assets at fair value through profit or loss' category, including interest and dividend income, are presented in the income statement in the period in which they arise.

Gains or losses arising from changes in the fair value of the 'available-for-sale financial assets' are recognised in equity.

When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments recognised in equity are included in the income statement as 'gains and losses from investment securities'. Interest on available-for-sale securities calculated using the effective interest method is recognised in the income statement. Dividends on available-for-sale equity instruments are recognised in the income statement when the Group's right to receive payments is established.

For unlisted equity shares, the Company establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, and option pricing models making maximum use of market inputs and relying as little as possible on entity-specific inputs.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2005

(Expressed in RON thousand, unless otherwise stated)

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The Company assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity securities classified as available for sale, a significant or prolonged decline in the fair value of the security below its cost is considered as an indicator that the securities are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in the income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement. Impairment testing of trade receivables is described in Note 3.7.

3.6 Inventories

Inventories are stated at the lower of restated cost and estimated net realizable value. Cost is calculated on a weighted average cost basis. Where necessary, provision is made for slow moving and obsolete inventories in order to arrive at the net realizable value. Obsolete or defective inventories identified individually are provided for in full. For slow moving inventories, an estimation of the age of inventories by each main category is made, based on the stock turnover by each main category and inventories older than one year, estimated as described above, are provided in full.

3.7 Trade receivables

Trade receivables are recorded at original invoice amount, less provision made for impairment of these receivables. A provision for impairment of trade receivables is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of 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 interest rate available in origination for similar borrowers.

3.8 Value added tax

Value added tax (VAT) is payable to the Tax Authorities based on the monthly VAT return by the 25th of the following month irrespective of collection of receivables from customers. The Fiscal Authorities permit the settlement of VAT on a net basis. When input VAT is higher than output VAT, the difference is refundable at the Company's request. The VAT refund may be made after a tax inspection is performed or without a tax inspection, if certain conditions are met. VAT related to sales and purchases which has not been settled at the balance sheet date is recognised in the balance sheet on a net basis and disclosed as a current asset or liability. Where provision has been made for impairment of receivables, impairment loss is recorded for the gross amount of the debtor, including VAT.

NOTES TO THE FINANCIAL STATEMENTS

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(Expressed in RON thousand, unless otherwise stated)

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The related VAT needs to be paid to the State and, starting 1 January 2004, can only be recovered after the debtor is declared bankrupt.

3.9 Cash and cash equivalents

Cash and cash equivalents include cash on hand and in the bank as well as all short-term debt instruments with a maturity of less than three months. For the purposes of the cash flow statement, cash and cash equivalents are presented net of bank overdrafts. In the balance sheet, bank overdrafts are included with borrowings in current liabilities.

3.10 Shareholders' equity

Share capital

Ordinary shares are classified as equity. External costs directly attributable to the issue of new shares, other than on a business combination, are shown as a deduction in equity from the proceeds. Any excess of the fair value of consideration received over the par value of shares issued is recognized as a share premium.

Dividends

Discretionary dividends are recognized 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 authorized for issue.

In accordance with Government Ordinance 64/2001, companies in which the state has a majority ownership have to distribute 50% of their net profit after deduction of compulsory distributions and contractual profit distributions to employees, as dividends to the state.

According to the provisions of the Emergency Government Ordinance 137/December 2004, approved by the Law 50/March 2005 net dividends related to 2004 as well as unpaid dividends from 2003 should be retained by the Company to finance its major investment projects relating to the modernization and development of the natural gas transportation infrastructure. As a consequence, unpaid dividends as distributed for 31 December 2003 and 31 December 2004 were reversed.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2005

(Expressed in RON thousand, unless otherwise stated)

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.11 Borrowings

Borrowings are recognized initially at the fair value of the proceeds received (which is determined using the prevailing market rate of interest for a similar instrument, if significantly different from the transaction price), net of transaction costs incurred. In subsequent periods, borrowings are stated at amortized cost using the effective yield method; any difference between fair value of the proceeds (net of transaction costs) and the redemption amount is recognized as interest expense over the period of the borrowings. The current portion of long-term borrowings is included within "Current Liabilities". Accrued interest at the balance sheet date is included within "Other payables and accruals" within current liabilities unless it is not payable within the following 12 months; in this latter case it is included within long term liabilities.

3.12 Leases

Leases where a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the statement of income on a straight-line basis over the period of the lease.

3.13 Income taxes

Income taxes have been provided for in the financial statements in accordance with Romanian legislation enacted or substantively enacted by the balance sheet date. The income tax charge comprises current tax and deferred tax and is recognised in the income statement unless it relates to transactions that are recognised, in the same or a different period, directly in equity.

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

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

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2005

(Expressed in RON thousand, unless otherwise stated)

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.14 Trade and other payable

Liabilities for trade and other payables are carried at cost which is the fair value of the consideration to be paid in the future for goods and services received, whether or not billed to the Company.

3.15 Employee benefits

Pension costs and other benefits at retirement

The Company, in the normal course of business, makes payments to the Romanian State on behalf of its employees. All employees of the Company are members of the Romanian State pension plan. These payments are recognised within the income statement together with the salaries expenses.

Under the collective labour contract, the Company should pay to its employees at the time of their retirement an amount equal to a multiplier of their gross salary depending on the employment period in the gas industry, working conditions, etc. The Company has recorded a provision for such payments. This provision has been computed based on the estimations of the average salary, average staff turnover, average number of salaries to be paid at the time of the retirement and the time frame when the benefits are to be paid. The provision has been discounted to its present value by applying a discount factor based on the risk free interest rate (i.e. interest rate on government bonds).

The Company does not operate any other pension scheme or post retirement benefit plan and, consequently, has no obligation in respect of pensions.

Social costs

The Company incurs employee costs related to the provision of benefits such as health services. These amounts principally represent an implicit cost of employing production workers and, accordingly, have been charged to wages and salaries costs.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2005

(Expressed in RON thousand, unless otherwise stated)

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.16 Provisions

Provisions for liabilities and charges are recognised when the Company has a present legal or constructive obligation as a result of past events, and 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 there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small. Where the Company 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.

The Company has recognised provisions in respect of lump sums payable on retirement (refer to paragraph 4.4 and also to note 19) as well as in respect of legal claims and guarantees (note 19). The long term provisions have been discounted to present value using a discount rate as detailed in note 19.

3.17 Revenue recognition

Revenue comprises the invoiced value of gas delivered and services rendered net of value-added tax, rebates and discounts.

Revenue from gas transportation and from the sale of gas is recognized when the gas has been delivered in accordance with contract; revenue from sale of goods is recognized when significant risks and rewards of ownership of the goods are transferred to the buyer.

Revenues are measured at the fair value of the consideration received or receivable. When the fair value of goods received in a barter transaction cannot be measured reliably, the revenue is measured at the fair value of the goods or service given up.

Interest income is recognised on a time-proportion basis using the effective interest method.

Dividends are recognised when the right to receive payment is established.

3.18 Mutual cancellation and barter transactions

A portion of sales and purchases are settled by mutual cancellations, barter or non-cash settlements. These transactions are generally in the form of direct settlements by dissimilar goods and services from the final customer (barter), cancellation of mutual balances or through a chain of non-cash transactions involving several companies.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2005

(Expressed in RON thousand, unless otherwise stated)

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Sales and purchases that are expected to be settled by mutual settlements, barter or other non-cash settlements are recognised based on the management's estimate of the fair value to be received or given up in non-cash settlements. The fair value is determined with reference to observable market information.

Non-cash transactions have been excluded from the cash flow statement, so investing activities, financing activities and the total of operating activities represent actual cash flows.

3.19 Foreign currency transactions

a) Functional currency

Items included in the financial statements of the Company are measured using the currency that best reflects the economic substance of the underlying events and circumstances relevant to that entity ("the functional currency"). The financial statements are presented in RON, which is the functional currency of the Company.

b) Transactions and balances

Monetary assets and liabilities are translated into Company's functional currency at the official exchange rate of the National Bank of Romania ("NBR") at the respective balance sheet date. Foreign exchange gains and losses resulting from the settlement of the transactions and from the translation of monetary assets and liabilities into the Company's functional currency at year-end official exchange rates of the NBR are recognised in profit or loss. Translation at year-end rates does not apply to non-monetary items, including equity investments. Effects of exchange rate changes on the fair value of equity securities are recorded as part of the fair value gain or loss.

At 31 December 2005, the exchange rate communicated by the National Bank of Romania, was US Dollar ("USD") 1 = RON 3.1078 (31 December 2004: USD 1 = RON 2.9067) and Euro ("EUR") 1 = RON 3.6771 (31 December 2004: EUR 1 = RON 3.9663). Exchange restrictions and currency controls exist relating to converting RON into other currencies. The RON is not a convertible currency outside of Romania.

3.20 Comparatives

Where necessary, comparative figures have been adjusted to conform with changes in presentation in the current year. Except as described in note 2.3, these changes did not have any impact on the result for the year ended 31 December 2004, on the net equity or the main balance sheet positions as at 31 December 2004.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2005

(Expressed in RON thousand, unless otherwise stated)

4 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

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

4.1 Tax legislation

Romanian tax, currency and customs legislation is subject to varying interpretations. Refer to Note 27(iii).

4.2 Related party transactions

In the normal course of business the Company enters into transactions with its related parties. These transactions are priced predominantly at market rates. Judgement is applied in determining if transactions are priced at market or non-market interest rates, where there is no active market for such transactions. The basis for judgment is pricing for similar types of transactions with unrelated parties and effective interest rate analyses.

4.3 Useful lives of property, plant and equipment

The management of the Company reviewed the useful lives of property, plant and equipment items and the implied residual values and concluded that no changes in estimates are necessary. The management of the Company estimates that the useful lives and method of depreciation used (Note 33.2) reflect accurately the pattern in which the future economic benefits are expected to be consumed by the Company.

4.4 Assumptions to determine amount of provision for retirement benefits

In calculating the present value of its future obligations towards employees upon their retirement, the Company has made assumptions primarily relating to the staff turnover and evolution of average salary.

TRANSGAZ SA

NOTES TO THE FINANCIAL STATEMENTS

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(Expressed in RON thousand, unless otherwise stated)

5 PROPERTY, PLANT AND EQUIPMENT

	<u>Land and buildings</u>	<u>Transportation system assets</u>	<u>Other fixed assets</u>	<u>Assets in course of construction</u>	<u>Total</u>
At 31 December 2003					
Cost	445,786	4,111,393	283,833	170,969	5,011,981
Accumulated depreciation	<u>(140,344)</u>	<u>(2,250,505)</u>	<u>(208,522)</u>	-	<u>(2,599,371)</u>
Net book value	<u>305,442</u>	<u>1,860,888</u>	<u>75,311</u>	<u>170,969</u>	<u>2,412,610</u>
Year ended					
31 December 2004					
Opening net book value	305,442	1,860,888	75,311	170,969	2,412,610
Additions	-	-	-	284,540	284,540
Transfers from AICC	16,621	281,589	33,062	(331,272)	-
Net book value of disposals	(1,411)	-	(4,842)	-	(6,253)
Impairment charge	-	(18,302)	-	-	(18,302)
Depreciation charge	<u>(12,473)</u>	<u>(119,744)</u>	<u>(18,513)</u>	-	<u>(150,730)</u>
Closing net book value	308,179	2,004,431	85,018	124,237	2,521,865
At 31 December 2004					
Cost	460,790	4,392,981	293,031	124,237	5,271,039
Accumulated depreciation	<u>(152,611)</u>	<u>(2,388,550)</u>	<u>(208,013)</u>	-	<u>(2,749,174)</u>
Net book value	<u>308,179</u>	<u>2,004,431</u>	<u>85,018</u>	<u>124,237</u>	<u>2,521,865</u>
Opening net book value	308,179	2,004,431	85,018	124,237	2,521,865
Additions	-	-	-	242,679	242,679
Transfers from AICC	5,745	241,307	11,449	(258,501)	-
Net book value of disposals	(2,632)	(3,091)	(543)	-	(6,266)
Depreciation charge	<u>(13,554)</u>	<u>(125,314)</u>	<u>(16,925)</u>	-	<u>(155,793)</u>
Closing net book value	297,738	2,117,333	78,999	108,415	2,602,485
At 31 December 2005					
Cost	462,928	4,577,671	297,101	108,415	5,446,115
Accumulated depreciation	<u>(165,190)</u>	<u>(2,460,338)</u>	<u>(218,102)</u>	-	<u>(2,843,630)</u>
Net book value	<u>297,738</u>	<u>2,117,333</u>	<u>78,999</u>	<u>108,415</u>	<u>2,602,485</u>

Transportation system assets comprise high pressure gas pipelines and the related assets such as compressor stations, measuring equipment, etc.

TRANSGAZ SA

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5 PROPERTY, PLANT AND EQUIPMENT (CONTINUED)

The gross book value of fully depreciated assets still in use is RON 1,470,703 (2004: RON 1,359,848).

Public property assets

Included in the transportation system assets are property, plant and equipment which are part of the public property of the State and are subject to the concession agreement as follows:

Cost	Year ended 31 December 2005	Year ended 31 December 2004
1 January 2005	2,686,874	2,736,495
Disposals	<u>-</u>	<u>49,621</u>
31 December 2005	2,686,874	2,686,874
Depreciation		
1 January 2005	2,029,300	1,996,184
Charge for the year	59,717	46,134
Impairment charge	-	18,301
Disposals	<u>-</u>	<u>(31,319)</u>
31 December 2005	2,089,017	2,029,300
Net book value	<u>597,857</u>	<u>657,574</u>

As detailed in note 3.4 these assets are administrated by Transgaz SA. Public property assets may not be sold by the Company.

In accordance with public property law (Law 213/1998) any new asset constructed by the Company which is part of the national gas transportation becomes public property once it is fully depreciated.

The costs of dismantling and removing public property assets and restoring the site on which they are located are not an obligation of the Company.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2005

(Expressed in RON thousand, unless otherwise stated)

5 PROPERTY, PLANT AND EQUIPMENT (CONTINUED)

According to the Government Decision 1644/October 2004, public property assets with a statutory gross book value of RON 8,917 which were no longer used by the Company, were transferred to the private property of the State, with the view of either decommissioning or transferring to other entities. Any proceeds on disposal of state property are transferred to the State budget. Because at 31 December 2004 no actual decommissioning or transfer was made, the Company's management decided to book an impairment provision in amount of RON 18,301, being the restated carrying amount of the respective assets, on the basis they are no longer generating revenues for the Company.

6 INTANGIBLE ASSETS

	<u>Computer software</u>	<u>Intangible in progress</u>	<u>Total</u>
At 31 December 2003			
Cost	16,311	7,009	23,320
Accumulated depreciation	<u>(10,137)</u>	-	<u>(10,137)</u>
Net book value	<u>6,174</u>	<u>7,009</u>	<u>13,183</u>
Year ended			
31 December 2004			
Opening net book value	6,174	7,009	13,183
Additions	8,679	6,759	15,438
Net book value of disposals	-	(13,328)	(13,328)
Depreciation charge	<u>(3,794)</u>	-	<u>(3,794)</u>
Closing net book value	11,059	440	11,499
At 31 December 2004			
Cost	24,990	440	25,430
Accumulated depreciation	<u>(13,931)</u>	-	<u>(13,931)</u>
Net book value	<u>11,059</u>	<u>440</u>	<u>11,499</u>
Opening net book value	11,059	440	11,499
Additions	4,161	299	4,460
Depreciation charge	<u>(5,410)</u>	-	<u>(5,410)</u>
Closing net book value	9,810	739	10,549
At 31 December 2005			
Cost	29,167	739	29,906
Accumulated depreciation	<u>(19,357)</u>	-	<u>(19,357)</u>
Net book value	<u>9,810</u>	<u>739</u>	<u>10,549</u>

TRANSGAZ SA

NOTES TO THE FINANCIAL STATEMENTS

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7 AVAILABLE FOR SALE FINANCIAL ASSETS

<u>Company</u>	<u>Activity</u>	<u>% Ownership</u>	<u>31 December 2005</u>	<u>31 December 2004</u>
Resial SA	manufacturing	68.16	18,116	18,116
Mebis SA	manufacturing	17.47	6,462	6,462
Wirom Gas SA	gas distribution and supply	9.94	2	0.9
Banca de Credit si Dezvoltare Romexterra SA	banking activity	0.57	1,158	1,158
Less provision for investments in Resial and Mebis			<u>(24,578)</u>	<u>(24,578)</u>
			<u>1,160</u>	<u>1,159</u>

Investment in Resial SA

The shares in Resial SA were received in December 2003 through forced collection of receivables from Coloni Serv Com SA. Due to the absence of audited financial information prepared in accordance with IFRS, the investment is not consolidated and carried at cost less impairment provision at 100% of cost, which reflects Resial's financial condition.

At 31 December 2004 the Company also pledged a deposit of RON 1,000 as guarantee for a loan taken by Resial SA. A provision of 100% of this amount was also made by the Company (Note 19). During year ended 31 December 2005, the provision was reversed as the guarantee was executed during this financial period.

Investment in Mebis SA

The shares in Mebis SA were received in February 2004 through forced collection of receivables from Coloni Serv Com SA. The investment is carried at cost less impairment provision at 100% of cost, which reflects Mebis's financial condition.

TRANSGAZ SA

NOTES TO THE FINANCIAL STATEMENTS

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7 AVAILABLE FOR SALE FINANCIAL ASSETS (CONTINUED)

Investment in Wirom Gas SA

At 31 December 2003 the Company held 49.97% of the shares (and corresponding voting rights) in Wirom Gas SA, a joint-venture with Wintershall Erdgas Handelshaus GmbH (49.97%) and other parties (0.06%). In February 2004 the Company sold 40% of its shares in Wirom SA to Distrigaz Sud SA.

The joint-venture was not proportionally consolidated or equity accounted for the first two months of 2004 due to its immaterial impact on financial position and results of the Company; consequently, it was classified as an available-for-sale investment.

During year ended 31 December 2005, the Company increased its contribution to the share capital of Wirom GAS SA with RON 1,370, in order to maintain the share of 9.97%.

8 INVENTORIES

	<u>31 December 2005</u>	<u>31 December 2004</u>
Spare parts and materials	41,195	43,753
Provisions for slow moving inventories	<u>(3,636)</u>	<u>(3,636)</u>
	<u>37,559</u>	<u>40,117</u>

9 TRADE AND OTHER RECEIVABLES

	<u>31 December 2005</u>	<u>31 December 2004</u>
Trade receivables	258,305	229,593
Advances from suppliers	3,531	3,965
VAT recoverable	1,228	8,417
Loan to subsidiary	3,068	2,432
Other receivables	2,006	1,099
Provision for impairment of receivables	(113,911)	(110,449)
Provision for impairment of loan to subsidiary	<u>(3,068)</u>	<u>(2,431)</u>
	<u>151,159</u>	<u>132,626</u>

TRANSGAZ SA

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9 TRADE AND OTHER RECEIVABLES (CONTINUED)

As at 31 December 2005, RON 36,704 (31 December 2004: RON 14,134) of net trade and other receivables are denominated in foreign currency, 91% in USD (2004: 100%) and 9% in EUR.

Included in trade receivables are balances from related parties of RON 90,333 (31 December 2004: RON 86,110), as presented in Note 25.

Trade receivables have been pledged in favour of banks as collateral for bank loans as described in Note 13.

10 CASH AND CASH EQUIVALENTS

	<u>31 December 2005</u>	<u>31 December 2004</u>
Cash at bank in RON	20,940	16,268
Cash at bank in foreign currency	45,061	38,377
Other cash equivalents	<u>185</u>	<u>149</u>
	<u>66,186</u>	<u>54,794</u>

As at 31 December 2005 cash at bank includes RON 3,068 (31 December 2004: RON 2,456) blocked deposits in foreign currencies and RON nil (31 December 2004: RON 1,280) deposit pledged in favour of banks and as guarantee for a loan taken by Resial SA (Note 7).

The weighted average effective interest rate on short term bank deposits was 4.31% at 31 December 2005 (31 December 2004: 4.90%) and these deposits had an average maturity of 30 days.

For the purpose of the cash flow statement, the year end cash and cash equivalents comprise the following:

	<u>31 December 2005</u>	<u>31 December 2004</u>
Cash and cash equivalents	66,186	54,794
Less: Bank overdrafts (Note 18)	<u>(33,148)</u>	<u>(29,953)</u>
	<u>33,038</u>	<u>24,841</u>

TRANSGAZ SA

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11 SHARE CAPITAL

	<u>Number of ordinary shares</u>	<u>Share capital</u>
Statutory		
At 31 December 2004	10,370,441	103,705
Increase	<u>9,879</u>	<u>99</u>
At 31 December 2005	10,380,320	103,804
IFRS		
Hyperinflation adjustment to share capital up to 31 December 2003		<u>441,418</u>
At 31 December 2005		<u>545,222</u>

The authorised and issued statutory share capital consists of shares with a nominal value of RON 10 each. Each share carries one vote. All shares are held by the Romanian State, represented by Ministry of Economy and Commerce (former "Ministry of Industry and Resources").

In its statutory books, the Company has recorded a revaluation of fixed assets and certain revaluation differences were used to increase the statutory share capital. For the purposes of these financial statements prepared in accordance with IFRS, such increases have not been recognised as the hyperinflationary adjustments on fixed assets were recognised annually in the Statement of Income up to 31 December 2003. Consequently, in these financial statements the Company has only recorded share capital contributed in cash or kind, inflated from the date of the original contribution to 31 December 2003. The share capital increases which occurred after 1 January 2004 have been recognised in nominal terms as hyperinflation ceased after this date.

The increase in 2005 relates to land which has been contributed to share capital by the Ministry of Economy and Commerce.

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12 PUBLIC PROPERTY RESERVE, LEGAL AND OTHER RESERVES

Public property reserve

A reserve corresponding to public property assets (Note 5) was included as part of equity under the heading "Public Property Reserve" at the statutory value of the respective assets restated up to 1 January 2004.

Distributable reserves

Legal reserve

In accordance with Romanian legislation and its Articles of Incorporation, the Company has to transfer five percent of its profits per statutory books to a statutory reserve which can cumulate up to 20% of the statutory share capital. The balance of the statutory reserve, which is not available for distribution at 31 December 2005, amounted to RON 20,761 (31 December 2004: RON 20,741). This reserve is restated and included within retained earnings in these financial statements.

Other reserves

The statutory accounting reports of the Company are the basis for profit distribution and other appropriations. Romanian legislation identifies the basis of distribution as the current year net income. For 2005, the statutory profit for the Company as reported in the published annual statutory reporting forms was RON 138,447 (31 December 2004: RON 179,003). However, this legislation and other statutory laws and regulations dealing with the distribution rights are open to legal interpretation and accordingly management believes at present it would not be appropriate to disclose an amount for the distributable reserves in these financial statements.

13 LONG TERM BORROWINGS

	<u>31 December 2005</u>	<u>31 December 2004</u>
IBRD loan	14,485	11,915
Gazprombank loan	193,841	219,624
Raiffeisen Bank loan	1,418	1,904
Efibanca loan	25,540	10,830
Less: current portion of loans	<u>(48,939)</u>	<u>(43,428)</u>
	<u>186,345</u>	<u>200,845</u>

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13 LONG TERM BORROWINGS (CONTINUED)

IBRD loan

The loan from the International Bank for Reconstruction and Development ("IBRD" - RO 3723) was given for the rehabilitation of the oil and gas sector in Romania under a Project Agreement signed on 1 June 1994.

As holding company of the Romgaz group of companies, the entire loan was nominally repayable by SNGN Romgaz, the predecessor company of Transgaz. However, in accordance with Government Decision 334/2000, subsequent to the latest restructuring of the gas sector following which Transgaz became a standalone entity, part of this borrowing was transferred to the newly created entities. The portion of the IBRD loan recognised by the Company is based upon an agreement concluded between the successor entities of SNGN Romgaz.

The Company also concluded a subsidiary loan agreement with the Ministry of Finance regarding its portion of this loan on 2 October 2001, and the original loan agreement between the Romanian Government and the IBRD has been amended to include the reorganisation of former Romgaz. The Company's portion of the loan has been determined at USD 7,768 thousand.

The loan is denominated in USD (the balances at 31 December 2005 and 31 December 2004 were USD 4,661 thousand and USD 4,099 thousand respectively) and carries an interest rate of 0.5% over the cost of Qualified Borrowings as defined by the IBRD. The interest rate applicable in 2005 was approximately 5 % (2004: approximately 5%). Repayments are made twice a year. The principal and interest are repaid to the Ministry of Finance at least 15 days prior to the date of repayment by the Ministry of Finance to IBRD. Payments to Ministry of Finance may also be made in RON equivalent at the exchange rate at the date of payment plus a 5% refundable fee in order to protect the Ministry of Finance against foreign exchange losses and a 10% commission to the interest paid.

The loan was entirely drawn down by 31 December 2005.

The loan is secured by a deposit made by the Company subsequent to the year end in favour of the Ministry of Finance. The deposit is equal with the following instalment to be repaid.

TRANSGAZ SA

NOTES TO THE FINANCIAL STATEMENTS

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13 LONG TERM BORROWINGS (CONTINUED)

Repayment schedule

The maturity of the IBRD loan is set out below:

	<u>31 December 2005</u>	<u>31 December 2004</u>
Within 1 year	1,282	1,115
Between 1 and 2 years	1,379	1,199
Between 2 and 5 years	4,792	4,167
Over 5 years	<u>7,032</u>	<u>5,434</u>
	<u>14,485</u>	<u>11,915</u>

Gazprombank loan

The Company contracted two loans from Gazprombank for investment projects. Both loans from Gazprombank are denominated in USD and they were entirely drawn up by 31 December 2005.

First loan

On 24 November 1999, the predecessor Company contracted a loan from Gazprombank, in order to finance the first stage of the construction of a new gas transit pipeline in Dobrogea.

The loan is repayable in monthly instalments and bears an interest rate of 0.5% per month for the outstanding balance.

The loan is collateralised by receivables from Gazexport under the gas transport contracts concluded with the Company, as well as any other receivables from Gazexport, in this order.

After the reorganisation of SNGN Romgaz SA the loan was taken over by Transgaz SA, the Company also being in charge of the related investment project (the Dobrogea transit pipeline).

Second loan

The second loan agreement with Gazprombank was concluded on 8 February 2001 for partial financing of the Dobrogea pipeline.

TRANSGAZ SA

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13 LONG TERM BORROWINGS (CONTINUED)

The loan is repayable in monthly installments. The loan bears an interest rate of 1 month LIBOR +2% (default interest rate: 1 month LIBOR +4%).

Repayment schedule

The aggregate maturity of the Gazprombank loans is set out bellow.

	<u>31 December 2005</u>	<u>31 December 2004</u>
Within 1 year	40,977	38,326
Between 1 and 2 years	40,978	38,326
Between 2 and 5 years	111,886	114,978
Over 5 years	<u>-</u>	<u>27,994</u>
	<u>193,841</u>	<u>219,624</u>

Raiffeisen Bank loans

First loan

The first loan from Raiffeisen Bank was contracted in April 2003 to finance the acquisition of specific equipment for the gas transportation network, purchased from RMA Maschinen und Armaturenbau Keh. The interest rate applied is EURIBOR 3 months + 2% per year. The loan is guaranteed with the present and future receivables from Distrigaz Sud SA, a pledge on the bank accounts opened at the bank and a promissory note. Reimbursements are made quarterly up to 31 March 2006.

Second loan

The second loan from Raiffeisen Bank was contracted in September 2005 for financing the modernization of some of the Company's assets (i.e. SMG Isaccea II). The loan bears an interest rate of EURIBOR 1 month + 2% per year and is to be reimbursed in 8 quarterly rates starting with October 2006.

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13 LONG TERM BORROWINGS (CONTINUED)

The maturity of the Raiffeisen Bank loan is set out below.

	<u>31 December 2005</u>	<u>31 December 2004</u>
Within 1 year	487	1,524
Between 1 and 2 years	533	380
Between 2 and 5 years	<u>398</u>	<u>-</u>
	<u>1,418</u>	<u>1,904</u>

Efibanca loans

The loans from Efibanca Spa, a company belonging to Banca Popolare di Lodi banking group, were contracted in June 2003, September 2004 and January 2005 to finance the acquisition of valves and related installation services from TYCO Valves&Controls ITALIA SRL and RMA Germany. The loans are denominated in EUR and bear an interest of 4.38%, 3.87% and 3.60% per annum, respectively. The repayment of each drawing is done in 10 bi-annual instalments.

The maturity of the Efibanca loans is set out below.

	<u>31 December 2005</u>	<u>31 December 2004</u>
Within 1 year	6,193	2,463
Between 1 and 2 years	6,193	2,463
Between 2 and 5 years	<u>13,154</u>	<u>5,904</u>
	<u>25,540</u>	<u>10,830</u>

Effective interest rate

Effective interest rate by category of loan can be summarized as follows:

	<u>Year ending</u> <u>31 December 2005</u>	<u>Year ending</u> <u>31 December 2004</u>
Long term loans in USD	5.2%	4.5%
Long term loans in EUR	3.2%	4.3%

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14 DEFERRED INCOME

Deferred income comprises connection fees that are charged to customers for connecting them into the gas transportation network. The deferred income is released over the period in which related assets (connection pipelines, gas flow regulator, counter) are depreciated.

15 LONG TERM TAX AND OTHER STATE PAYABLES

Long-term taxes payable comprise various taxes payable to the State which were previously overdue and which have been restructured to be repaid over a period of up to 5 years ending March 2006, as described below. The net present value of this debt and its maturity profile is as follows:

	<u>31 December 2005</u>	<u>31 December 2004</u>
Current	-	12,111
1 to 2 years	<u>-</u>	<u>2,155</u>
Total restructured	-	14,266
Less: current portion of restructured taxes	<u>-</u>	<u>(12,111)</u>
Long-term portion of restructured taxes	<u>-</u>	<u>2,155</u>

Current portion of restructured taxes is included in current tax and other state payable.

The rescheduled tax liabilities accrued interest and penalties of 0.06% per day up to 31 August 2005 and 0.05% per day after 31 August 2005 which is equal to an effective rate of 21% per annum (2004: 22%).

TRANSGAZ SA

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16 TAXATION

Income tax expense /(release)

	Year ended <u>31 December 2005</u>	Year ended <u>31 December 2004</u>
Income tax expense - current	36,744	65,501
Deferred tax release - origination and reversal of temporary differences	(16,970)	(17,534)
Deferred tax release -effect of reduction in tax rate	_____ -	<u>(103,191)</u>
Income tax expense/(release)	<u>19,774</u>	<u>(55,224)</u>

In 2005, the Company accrued income taxes at the rate of 16% on profits computed in accordance with the Romanian tax legislation. Profit before taxation for financial reporting purposes is reconciled to tax expense as follows:

	Year ended <u>31 December 2005</u>	Year ended <u>31 December 2004</u>
Profit before taxation	115,778	168,836
Theoretical tax charge at statutory rate of 16% (25% for 2004)	18,525	42,209
Tax effect of items which are not deductible or assessable for taxation purposes:		
Impact of IFRS adjustments on equity	(9,678)	1,383
Non-taxable income	(3,612)	(4,370)
Non-deductible expenses	14,539	8,745
Effect of reduction in tax rate	_____ -	<u>(103,191)</u>
Income tax expense /(release)	<u>19,774</u>	<u>(55,224)</u>

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16 TAXATION (CONTINUED)

Deferred tax

Deferred tax assets and liabilities are measured at the effective tax rate of 16% as at 31 December 2005 and 31 December 2004. The movement on the deferred income tax account is as follows:

	<u>Year ended</u> <u>31 December 2005</u>	<u>Year ended</u> <u>31 December 2004</u>
At the beginning of the year	164,458	285,183
Release for the year	<u>(16,970)</u>	<u>(120,725)</u>
At the end of the year	<u>147,488</u>	<u>164,458</u>

Deferred tax assets and liabilities and deferred tax expense/(income) in the income statement are attributable to the following items:

	<u>31 December 2005</u>	<u>Movement</u>	<u>31 December 2004</u>
Deferred tax liabilities			
Restatement of property, plant and equipment	153,025	(16,685)	169,710
Other taxable temporary differences	<u>75</u>	<u>1</u>	<u>74</u>
	153,100	(16,684)	169,784
Deferred tax assets			
Accruals	696	74	622
Adjustments to inventories	184	78	106
Impairment of property, plant and equipment	2,928	-	2,928
Provision for employee benefits	<u>1,804</u>	<u>134</u>	<u>1,670</u>
	5,612	286	5,326
Net deferred tax liability	<u>147,488</u>	<u>(16,970)</u>	<u>164,458</u>

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16 TAXATION (CONTINUED)

The amounts shown in the balance sheet include the following:

	<u>31 December 2005</u>	<u>31 December 2004</u>
Deferred tax liabilities to be settled after more than 12 months	<u>141,074</u>	<u>157,605</u>

17 TRADE AND OTHER PAYABLES

	<u>31 December 2005</u>	<u>31 December 2004</u>
Trade payables	70,924	35,944
Suppliers of fixed assets	60,444	51,062
Penalties for dividends not paid during 2000-2003	45,483	-
Other taxes	16,185	8,993
Employees payable	7,980	8,190
Dividends	4,000	-
Other liabilities	<u>5,036</u>	<u>3,058</u>
	<u>210,052</u>	<u>107,247</u>

As detailed in the Statement of changes in the shareholders' equity, the Ministry of Economy and Commerce, as sole shareholder of Transgaz, has decided to charge the Company penalties for declared and unpaid dividends dating from the period 2000-2003. These penalties are in substance a distribution to shareholders, therefore the Company's management decided to record and present them as a movement in retained earnings.

As at 31 December 2005, RON 12,702 (31 December 2004: RON 20,269) of trade and other payables are denominated in foreign currency, mainly USD.

Included in trade payables are balances due to related parties of RON 43,691 (31 December 2004: RON 20,207), as presented in Note 25.

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18 SHORT TERM BORROWINGS

Short-term borrowings are analyzed as follows:

	<u>Currency</u>	<u>31 December 2005</u>	<u>31 December 2004</u>
1. BRD overdraft	RON	14,310	18,202
2. ABN AMRO Bank overdraft	RON	18,838	11,751
Current portion of long term loans (Note 13)		<u>48,939</u>	<u>43,428</u>
		<u>82,087</u>	<u>73,381</u>

1. BRD overdraft

BRD overdraft agreement has been concluded in 2004 with a RON 20,000 ceiling and was initially due in August 2005. The facility is secured with a pledge on receivables from the contract with Azomures and on cash accounts with BRD. In August 2005, the Company concluded another contract with the same bank, for a facility maturing in July 2006 and secured with a pledge on receivables from the contract with Electrocentrale Bucuresti SA.

Interest rate is BUBOR + 1% p.a. The effective interest rate in 2005 was 11% (2004:20%).

2. ABN AMRO Bank overdraft

ABN AMRO Bank overdraft agreement was concluded in 2004 with a RON 20,000 ceiling and initially due in October 2005. In April 2005, the maturity of the facility was extended to October 2006. The overdraft is secured by general pledge over the Company's receivables. Interest rate is BUBOR + 0.95% p.a. The effective interest rate in 2005 was 11% (2004: 20%).

The carrying amount of short-term borrowings approximates their fair value.

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19 PROVISIONS FOR LIABILITIES AND CHARGES

	<u>31 December 2005</u>	<u>31 December 2004</u>
<i>Current provision</i>		
Provision for litigations	12,969	11,474
Provision for guarantees issued	<u>-</u>	<u>1,000</u>
	<u>12,969</u>	<u>11,474</u>
<i>Non-current provision</i>		
Provision for employee benefits	<u>11,278</u>	<u>10,443</u>

Legal claims

As at 31 December 2004 the Company recorded provisions in respect of the litigation with the "Gas Federation" trade union (Note 27). As at 31 December 2005 the provision for litigations was increased due to a new law case with Petrom SA.

Provision for guarantees

As at 31 December 2004, the Company has recorded the provision for guarantees issued for a loan taken by Resial SA (Note 7). As at 31 December 2005, this provision has been released as the Company had to disburse the guarantee amount in 2005.

Retirement obligations

Under the collective labour contract, the Company should pay to its employees at the time of their retirement a lump-sum amount equal to a multiplier of their gross salary depending on the employment period in the gas industry, working conditions, etc. This provision in respect of these liabilities has been computed based on the estimations of the average salary, average number of salaries to be paid at the time of the retirement and the time frame when the benefits are to be paid. The provision has been discounted to its present value by applying a discount factor based on the risk free interest rate (i.e. interest rate afferent to government bonds).

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20 REVENUE

	<u>Year ended</u> <u>31 December 2005</u>	<u>Year ended</u> <u>31 December 2004</u>
Revenue from domestic gas transportation services	510,248	434,774
Revenue from international gas transit services	219,546	242,316
Revenue from sales of gas	36,836	91,130
Revenue from other services	<u>558</u>	<u>557</u>
	<u>767.188</u>	<u>768.777</u>

21 OTHER INCOME

	<u>Year ended</u> <u>31 December 2005</u>	<u>Year ended</u> <u>31 December 2004</u>
Reimbursement of interest overpaid to State Budget	6,905	627
Reimbursement of penalties for late payment	2,157	-
Other operating revenues	<u>4,315</u>	<u>4,800</u>
	<u>13,377</u>	<u>5,427</u>

22 OTHER OPERATING EXPENSES

	<u>Year ended</u> <u>31 December 2005</u>	<u>Year ended</u> <u>31 December 2004</u>
Maintenance and transportation	40,886	14,951
Third party services	10,907	8,631
Loss on disposal	7,743	6,371
Penalties	3,261	7,029
Utilities	2,903	2,157
Telecom	2,564	2,615
Bank and other commissions	1,391	864
Research and development	1,386	1,737
Rent	594	812
Insurance premium	430	326
Bad debts written off	85	2,450
Charges in inventory of finished goods and work in progress	(1)	333
Other	<u>10,079</u>	<u>6,517</u>
	<u>82,228</u>	<u>54,793</u>

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23 NET FINANCIAL INCOME/ (EXPENSE)

	<u>Year ended</u> <u>31 December 2005</u>	<u>Year ended</u> <u>31 December 2004</u>
Foreign exchange gains	10,319	30,821
Foreign exchange losses	(18,944)	(8,710)
Interest income	2,606	2,872
Interest expense	<u>(16,330)</u>	<u>(15,771)</u>
	<u>(22,349)</u>	<u>9,212</u>

24 NET CASH-FLOW FROM OPERATING ACTIVITY

	<u>Year ended</u> <u>31 December 2005</u>	<u>Year ended</u> <u>31 December 2004</u>
Net profit before taxation	115,778	168,836
<i>Adjustments for:</i>		
Depreciation and amortisation	161,203	154,524
Provision for impairment of property, plant and equipment	-	18,302
Loss on disposal of fixed assets	7,743	6,371
Provisions for liabilities and charges	1,331	13,800
Provisions for debtors and inventories	4,099	(14,597)
Bad debts written off	85	2,450
Net interest expense	13,724	12,899
Effect of exchange rate changes on non-operating items	9,829	(25,640)
Operating profit before working capital changes	313,792	336,945
(Increase)/decrease in trade and other debtors	(22,525)	104,065
Decrease/(increase) in inventories	2,558	(2,756)
Increase/(decrease) in trade and other creditors	<u>21,002</u>	<u>(20,923)</u>
Cash generated from operations	<u>314,827</u>	<u>417,331</u>

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25 TRANSACTIONS WITH RELATED PARTIES

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions or is under common control with another party as defined by IAS 24 "Related Party Disclosure". In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

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

The sole shareholder of the Company as at 31 December 2004 and 31 December 2005 was Romanian State represented by the Ministry of Economy and Commerce (the former Ministry of Industries and Resources). The related parties presented below are majority owned by the Romanian State and thus presented as entities under common control.

The related parties presented below are majority owned by the Romanian State. No transaction with the Company's subsidiary, Resial SA, took place during 2004 and 2005. However, the Company has issued a guarantee in amount of RON 1,000 for a loan taken by Resial. A full provision was made for this amount as at 31 December 2004. The provision was reversed in 2005 after the Company disbursed the guarantee amount in 2005.

During the years ended 31 December 2005 and 2004 the following transactions were carried out with related parties (entities majority owned by the Romanian State) and the following balances were payable/receivable at the respective dates:

i) Revenues from related parties – services and gas sold

	<u>Relationship</u>	<u>31 December 2005</u>	<u>31 December 2004</u>
SNGN Romgaz	Entity under common control	44,124	135,609
Termoelectrica	Entity under common control	7,282	12,869
Electrocentrale Deva SA	Entity under common control	4,690	6,572
Electrocentrale București SA	Entity under common control	70,588	67,043
Electrocentrale Galați SA	Entity under common control	<u>6,778</u>	<u>-</u>
		<u>133,462</u>	<u>222,093</u>

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25 TRANSACTIONS WITH RELATED PARTIES (CONTINUED)

ii) Receivables from related parties

	<u>Relationship</u>	<u>31 December 2005</u>	<u>31 December 2004</u>
SNGN Romgaz	Entity under common control	-	890
Termoelectrica	Entity under common control	81,624	77,120
Electrocentrale Deva SA	Entity under common control	384	1,354
Electrocentrale București SA	Entity under common control	7,320	6,746
Electrocentrale Galați SA	Entity under common control	879	-
Grup Dezvoltare Rețele SA	Entity under common control	<u>126</u>	<u>-</u>
		<u>90.333</u>	<u>86.110</u>

iii) Acquisitions of services from related parties (gas storage)

	<u>Relationship</u>	<u>31 December 2005</u>	<u>31 December 2004</u>
SNGN Romgaz	Entity under common control	<u>91,721</u>	<u>62,320</u>

iv) Payables to related parties

	<u>Relationship</u>	<u>31 December 2005</u>	<u>31 December 2004</u>
SNGN Romgaz	Entity under common control	<u>43.691</u>	<u>20,207</u>

v) Key management compensation

	<u>Year ended</u> <u>31 December 2005</u>	<u>Year ended</u> <u>31 December 2004</u>
Salaries paid to key management	<u>1,480</u>	<u>1,371</u>

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26 SIGNIFICANT NON-CASH TRANSACTIONS

Mutual cancellations

Approximately 9% of accounts receivable were settled via non-cash transactions during the year ended 31 December 2005 (2004: 37%). The transactions represent mainly sale of products and services in exchange of raw materials and services or cancellation of mutual balances with customers and suppliers within the operating cycle.

Barter transactions

The barter transactions during 2004 were of RON 172,248 (2004: RON 89,415). These transactions represent gas received from Gazexport in exchange for the gas transit services for Turkey and Greece.

27 CONTINGENCIES, COMMITMENTS AND OPERATING RISKS

(i) Contingencies

Public property assets

According to the Concession agreement, the level of the royalty to be paid in respect with public property assets, which has been set at 5% of the revenues from gas transportation and transit for the period 2002 - 2006, is to be revised after 2006. Consequently, there is a risk that the level of the royalty may be increased after that date.

According to the Concession agreement, assets constructed by the Company between 31 July 1999 and 30 September 2001, with a statutory gross book value of RON 219,300, which are by their nature part of the National Gas Transportation System, are to be returned to ANRM at the end of the Concession Agreement.

(ii) Commitments

Public property assets

As stipulated in the Appendix 4 of the Concession agreement, the Company should accomplish a minimum compulsory capital expenditure program for the modernization of the National Gas Transportation System for the period 2004-2006, as follows:

2004	RON 154,200
2005	RON 204,900
2006	RON 193,400

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2005

(Expressed in RON thousand, unless otherwise stated)

27 CONTINGENCIES, COMMITMENTS AND OPERATING RISKS (CONTINUED)

The Concession Agreement also specifies the following:

- ANRM has the option to buy the assets which are of Public Property as listed in the Concession agreement upon expiry of the concession agreement, at a price equal with their statutory net book value at that time (revaluations being allowed);
- All operational expenses related to the operation of the public property assets are covered by Transgaz;
- The National Gas Transportation System cannot be divided and includes any development (resulting in increased capacity) or improvement (resulting in improved functional parameters);
- Changes in transport tariffs must be approved by ANRM;
- No sub-concessions are allowed;
- ANRM establishes tariffs and approves improvements and/or development work;
- ANRM can require Transgaz to accept a client;
- ANRM can decide to finance improvement/development works;
- Transgaz is liable for all environment damages which may result from the operation of the National Gas Transportation System.

(iii) Taxation

The Romanian taxation system is undergoing a process of consolidation and harmonisation with the European Union legislation. However, there are still different interpretations of the fiscal legislation. In various circumstances, the tax authorities may have different approaches to certain issues, and assess additional tax liabilities, together with late payment interest and penalties (respectively 0.06% per day of delay up to 31 August 2005 and 0.05% per day of delay after 31 August 2005). In Romania, tax periods remain open for 5 years. The company's management considers that the tax liabilities included in these financial statements are fairly stated.

(iv) Insurance policies

The Company holds no insurance policies in relation to its operations, product liability, or in respect of public liability or other insurable risks.

(v) Environmental matters

Environmental regulations are developing in Romania and the Company has not recorded any liability at 31 December 2005 for any anticipated costs, including legal and consulting fees, site studies, the design and implementation of remediation plans, related to environmental matters. Management do not consider the costs associated with environmental issues to be significant.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2005

(Expressed in RON thousand, unless otherwise stated)

27 CONTINGENCIES, COMMITMENTS AND OPERATING RISKS (CONTINUED)

(vi) **Legal proceedings**

During the year, the Company was involved in a number of court proceedings (both as a plaintiff and a defendant) arising in the ordinary course of business. Except for the matter described below, the Company's management believes that the ultimate resolution of these matters will not have a material adverse effect on the amounts of operations or the financial position of the Company.

Following legal action taken in 2004 by the Gas Federation of Romania, a trade union, the Company was requested to pay an amount of RON 11,473 through decision no 94/2005 issued by Alba County Court of Law. This amount represents the value of gas that the Company should have distributed to employees based on the Collective Labour Agreement for 2004. The Company disagreed with this decision and filed an appeal to the Appeal Court, which was rejected in 2005. A provision of RON 11,473 was recorded in the Company accounts as at 31 December 2004. The Company's management considers that the provision needs to be maintained in 2005, as the Collective Labour Contract was also in force during this financial period.

(vii) **Operating environment of the Company**

The Romanian economy 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 outside Romania, restrictive currency controls, and relatively high inflation. The tax, currency and customs legislation within Romania is subject to varying interpretations, and changes, which can occur frequently. Whilst there have been marked improvements in the economic trends, the future economic direction of Romania is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the government, together with tax, legal, regulatory and political developments.

(viii) **Government policy in the gas sector in Romania**

As part of the ongoing process of restructuring of the gas sector in Romania, the Romanian Government and Parliament may continue to adopt new legislation, including privatisation regulations, that impacts the sector in general, and the Company in particular. It is not possible to establish at this stage the effects, if any, of future Government policy in the gas sector in Romania on the value of the assets and liabilities of the Company. The Government of Romania is ultimately the sole shareholder of the Company.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2005

(Expressed in RON thousand, unless otherwise stated)

28 FINANCIAL RISKS

(i) **Credit risk**

Financial assets, which potentially subject Company entities to credit risk, consist principally of trade receivables. The Company has policies in place to ensure that sales of products and services are made to customers with an appropriate credit history. The carrying amount of accounts receivable, net of bad debt provision, represents the maximum amount exposed to credit risk. The Company's credit risk is concentrated on top 5 clients, which make up 86% of trade receivable balance at 31 December 2005 (2004: 91%). Although collection of receivables could be influenced by economic factors, management believes that there is no significant risk of loss to the Company beyond the provision already recorded.

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

(ii) **Liquidity risk**

Prudent liquidity risk management implies maintaining sufficient cash and availability of funding through an adequate amount of committed credit facilities

(iii) **Interest rate risk**

The Company is exposed to interest rate risk through its interest-bearing long-term borrowings. The Company has not entered into any arrangements to mitigate this risk. The Company has no significant interest-bearing assets.

(iv) **Fair values**

The carrying amount of financial assets and liabilities with a maturity of less than one year approximate their fair values. At 31 December 2005 and 31 December 2004, the fair value of long-term debt which is estimated by discounting the future contractual cash flows at the current market interest rate available for similar financial instruments, did not materially differ from the carrying amount of the financial instruments.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2005

(Expressed in RON thousand, unless otherwise stated)

28 FINANCIAL RISKS (CONTINUED)

(v) Currency risk

The Company attracts substantial amount of foreign currency denominated long-term borrowings and is thus exposed to foreign exchange risk. Foreign currency denominated assets and liabilities give rise to foreign exchange exposure.

The Company does not have formal arrangements to mitigate currency risks of the Company's operations. However, management believes that the Company is secured from foreign exchange risks as foreign currency denominated sales are used to cover repayment of foreign currency denominated borrowings.

Monetary assets and liabilities denominated in RON and other currencies are stated below:

	<u>31 December 2005</u>	<u>31 December 2004</u>
Assets		
Monetary assets in RON	172,274	149,037
Monetary assets in foreign currency	<u>45,071</u>	<u>38,384</u>
	217,345	187,421
Liabilities		
Monetary liabilities in RON	(247,311)	(34,284)
Monetary liabilities in foreign currency	<u>(235,284)</u>	<u>(371,302)</u>
	(482,595)	(405,586)
Net monetary position in RON	<u>(75,037)</u>	<u>114,753</u>
Net monetary position in foreign currency	<u>(190,213)</u>	<u>(332,918)</u>

29 SUBSEQUENT EVENTS

Dividends

In May 2006 the Company declared dividends in amount of RON 71,389 for 2005.