# JSFC SISTEMA AND SUBSIDIARIES

**Consolidated Financial Statements**
As of December 31, 2010 and 2009 and
For the Years Then Ended

# JSFC SISTEMA AND SUBSIDIARIES

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**INDEPENDENT AUDITORS' REPORT**

To the Shareholders of JSFC Sistema:

We have audited the accompanying consolidated statements of financial position of JSFC Sistema and its subsidiaries (the "Group") as of December 31, 2010 and 2009 and the related consolidated statements of operations, cash flows and changes in shareholders' equity and comprehensive income for the years then ended. These financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of JSFC Sistema and its subsidiaries as of December 31, 2010 and 2009, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche

April 26, 2011

Moscow, Russia

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# JSFC SISTEMA AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
## AS OF DECEMBER 31, 2010 AND 2009
***(Amounts in thousands of U.S. dollars, except share amounts)***

| | Notes | 2010 | 2009 |
|---|---|---|---|
| **ASSETS** | | | |
| CURRENT ASSETS: | | | |
| Cash and cash equivalents | 5 | $ 2,265,068 | $ 3,436,680 |
| Assets from banking activities, current portion, including cash and cash equivalents of $2,785,596 and $2,163,852 | 6 | 5,489,606 | 5,184,265 |
| Short-term investments | 7 | 879,680 | 575,966 |
| Accounts receivable, net | 8 | 1,726,674 | 1,334,169 |
| Prepaid expenses, other receivables and other current assets, net | | 1,705,955 | 1,358,226 |
| VAT receivable | | 649,690 | 302,703 |
| Inventories and spare parts | 9 | 1,501,012 | 1,137,294 |
| Deferred tax assets, current portion | 19 | 357,821 | 348,965 |
| Total current assets | | 14,575,506 | 13,678,268 |
| NON-CURRENT ASSETS: | | | |
| Property, plant and equipment, net | 10 | 19,039,699 | 19,266,950 |
| Advance payments for non-current assets | | 1,426,607 | 502,481 |
| Goodwill | 11 | 1,872,520 | 1,696,993 |
| Other intangible assets, net | 12 | 3,022,973 | 2,798,002 |
| Investments in and loans to affiliates | 13 | 1,147,694 | 631,822 |
| Investment in shares of Svyazinvest | 14 | - | 859,668 |
| Assets from banking activities, net of current portion | 6 | 1,812,743 | 1,614,968 |
| Debt issuance costs, net | | 159,803 | 162,525 |
| Deferred tax assets, net of current portion | 19 | 317,195 | 243,569 |
| Long-term investments | | 469,742 | 292,277 |
| Other non-current assets | | 264,629 | 263,517 |
| Total non-current assets | | 29,533,605 | 28,332,772 |
| TOTAL ASSETS | | $ 44,109,111 | $ 42,011,040 |

See notes to consolidated financial statements.

## JSFC SISTEMA AND SUBSIDIARIES

### CONSOLIDATED STATEMENTS OF FINANCIAL POSITION (CONTINUED)
### AS OF DECEMBER 31, 2010 AND 2009
***(Amounts in thousands of U.S. dollars, except share amounts)***

| | Notes | 2010 | 2009 |
|---|---|---|---|
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | | |
| CURRENT LIABILITIES: | | | |
| Accounts payable | | $ 1,775,698 | $ 1,416,118 |
| Liabilities from banking activities, current portion | 15 | 4,191,836 | 3,789,248 |
| Taxes payable | | 674,269 | 736,834 |
| Deferred tax liabilities, current portion | 19 | 168,982 | 87,415 |
| Subscriber prepayments, current portion | | 579,952 | 554,409 |
| Accrued expenses and other current liabilities | 16 | 3,341,647 | 2,352,489 |
| Short-term loans payable | 17 | 1,092,599 | 504,458 |
| Current portion of long-term debt | 18 | 2,103,405 | 3,736,708 |
| Total current liabilities | | 13,928,388 | 13,177,679 |
| LONG-TERM LIABILITIES: | | | |
| Long-term debt, net of current portion | 18 | 12,206,515 | 11,204,055 |
| Liabilities from banking activities, net of current portion | 15 | 1,444,783 | 1,455,402 |
| Deferred tax liabilities, net of current portion | 19 | 1,636,583 | 1,610,725 |
| Asset retirement obligation | 2 | 258,382 | 189,490 |
| Subscriber prepayments, net of current portion | | 142,316 | 130,153 |
| Postretirement benefits obligation | | 87,201 | 60,869 |
| Property, plant and equipment contributions | | 89,067 | 90,411 |
| Total long-term liabilities | | 15,864,847 | 14,741,105 |
| TOTAL LIABILITIES | | 29,793,235 | 27,918,784 |
| Commitments and contingencies | 25 | | |
| Redeemable noncontrolling interests | 2 | 107,343 | 82,261 |
| SHAREHOLDERS' EQUITY: | | | |
| Share capital (9,650,000,000 shares issued; and 9,281,827,594 shares outstanding with par value of 0.09 Russian Rubles) | 21 | 30,057 | 30,057 |
| Treasury stock (368,172,406 shares with par value of 0.09 Russian Rubles; 2009: 371,018,060 shares) | | (463,733) | (466,345) |
| Additional paid-in capital | | 2,100,323 | 1,745,386 |
| Retained earnings | | 6,471,327 | 5,577,759 |
| Accumulated other comprehensive loss | | (171,149) | (93,647) |
| Total JSFC Sistema shareholders' equity | | 7,966,825 | 6,793,210 |
| Nonredeemable noncontrolling interests in equity of subsidiaries | | 6,241,708 | 7,216,785 |
| TOTAL EQUITY | | 14,208,533 | 14,009,995 |
| TOTAL LIABILITIES AND EQUITY | | $ 44,109,111 | $ 42,011,040 |

See notes to consolidated financial statements.

# JSFC SISTEMA AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF OPERATIONS
## FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009
***(Amounts in thousands of U.S. dollars, except share and per share amounts)***

| | Notes | 2010 | 2009 |
|---|---|---|---|
| Sales | | $ 27,509,526 | $ 18,052,589 |
| Revenues from banking activities | | 588,947 | 697,227 |
| TOTAL REVENUES | | 28,098,473 | 18,749,816 |
| Cost of sales, exclusive of depreciation and amortization shown separately below | | (11,784,763) | (7,598,159) |
| Cost related to banking activities, exclusive of depreciation and amortization shown separately below | | (374,037) | (540,263) |
| Selling, general and administrative expenses | | (3,838,496) | (3,068,593) |
| Depreciation, depletion and amortization | | (2,946,382) | (2,490,514) |
| Transportation costs | | (535,390) | (159,001) |
| Provision for doubtful accounts | | (146,617) | (261,182) |
| Loss from impairment and provisions for other assets | | (293,919) | (362,215) |
| Impairment of investment in Svyazinvest | 14 | - | (349,370) |
| Taxes other than income tax | | (4,118,603) | (1,617,547) |
| Other operating expenses, net | | (267,711) | (452,313) |
| Equity in results of affiliates | | 92,236 | (12,758) |
| Gain on acquisition of subsidiaries and affiliates | 13, 3 | 477,400 | 2,782,835 |
| Loss on disposal of interests in subsidiaries and affiliates | | - | (383,978) |
| OPERATING INCOME | | 4,362,191 | 4,236,758 |
| Interest income | | 131,428 | 192,176 |
| Change in fair value of derivative instruments | 20 | (2,062) | (35,200) |
| Interest expense, net of amounts capitalized | | (1,597,238) | (1,246,361) |
| Foreign currency transaction gains/(losses) | | 26,456 | (92,825) |
| Income from continuing operations before income tax | | 2,920,775 | 3,054,548 |
| Income tax expense | 19 | (1,088,963) | (746,668) |
| Equity in net income of energy companies in the Republic of Bashkortostan | | - | 4,400 |
| Income from continuing operations | | $ 1,831,812 | $ 2,312,280 |
| Loss from discontinued operations, net of income tax effect of $nil | | (39,269) | - |
| Gain/(loss) from disposal of discontinued operations, net of income tax effect of $nil | 4 | 324,656 | (26,194) |
| NET INCOME | | $ 2,117,199 | $ 2,286,086 |
| Noncontrolling interests | | (1,198,502) | (642,645) |
| NET INCOME ATTRIBUTABLE TO JSFC SISTEMA | | $ 918,697 | $ 1,643,441 |
| Weighted average number of common shares outstanding | | 9,280,322,906 | 9,278,981,940 |
| Income per share, basic and diluted, US cents | | | |
| Income from continuing operations | | 6.82 | 17.99 |
| Gain/(loss) from discontinued operations | | 3.08 | (0.28) |
| Net income attributable to JSFC Sistema shareholders | | 9.90 | 17.71 |

See notes to consolidated financial statements.

# JSFC SISTEMA AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS
## FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009
***(Amounts in thousands of U.S. dollars)***

| | 2010 | 2009 (As revised, Note 2) |
|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES:** | | |
| Net income | $ 2,117,199 | $ 2,286,086 |
| Adjustments to reconcile net income to net cash provided by operations: | | |
| Depreciation, depletion and amortization | 2,946,382 | 2,490,514 |
| (Gain)/loss from disposal of discontinued operations | (324,656) | 26,194 |
| Loss from discontinued operations | 39,269 | - |
| Gain on acquisition of subsidiaries and affiliates (see Notes 13 and 3) | (477,400) | (2,782,835) |
| Equity in results of affiliates | (92,236) | 8,358 |
| Dividends received from affiliates | 34,937 | 107,735 |
| Deferred income tax benefit | (27,932) | (29,954) |
| Change in fair value of derivative financial instruments | 2,062 | 35,200 |
| Foreign currency transactions (gain)/loss | (26,456) | 92,825 |
| Debt issuance cost amortization | 89,244 | 51,707 |
| Non-cash compensation to employees | 70,978 | 10,946 |
| Non-cash expenses associated with asset retirement obligation | 8,925 | 5,916 |
| Loss on disposal of interests in subsidiaries and affiliates | - | 383,978 |
| Loss from impairment and provisions of other assets | 293,919 | 362,215 |
| Loss from impairment of investment in Svyazinvest | - | 349,370 |
| Loss on disposal of property, plant and equipment | 32,124 | 8,624 |
| Amortization of connection fees | (95,706) | (36,449) |
| Provision for doubtful accounts receivable | 146,617 | 261,182 |
| Allowance for loan losses | 29,052 | 34,606 |
| Other | - | 18,957 |
| Changes in operating assets and liabilities, net of effects from purchase of businesses: | | |
| Trading securities | 120,236 | (99,224) |
| Accounts receivable | (538,393) | (234,463) |
| VAT receivable | (345,974) | (133,088) |
| Prepaid expenses, other receivables and other current assets | (348,522) | 256,753 |
| Inventories | (406,494) | (120,194) |
| Accounts payable | 230,712 | (484,882) |
| Subscriber prepayments | 132,105 | 77,871 |
| Taxes payable | (64,502) | 297,738 |
| Accrued expenses and other liabilities | 455,931 | 442,544 |
| Postretirement benefit obligation | 55,331 | (3,661) |
| Net cash provided by operations | $ 4,056,752 | $ 3,684,569 |

## CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)
## FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009
***(Amounts in thousands of U.S. dollars)***

| | 2010 | 2009 (As revised, Note 2) |
|---|---|---|
| **CASH FLOWS FROM INVESTING ACTIVITIES:** | | |
| Payments for purchases of property, plant and equipment | (3,486,468) | (3,000,930) |
| Payments for purchases of intangible assets | (693,106) | (433,486) |
| Payments for purchases of businesses, net of cash acquired | (364,532) | (1,729,063) |
| Proceeds from sale of subsidiaries, net of cash disposed | 307,358 | 123,165 |
| Payments for purchases of long-term investments | (478,530) | (758,591) |
| Payments for purchases of short-term investments | (851,325) | (936,122) |
| Payments for purchases of other non-current assets | (78,286) | (145,914) |
| Proceeds from sale of other non-current assets | 92,430 | 35,649 |
| (Increase)/decrease in restricted cash | (16,445) | 11,778 |
| Proceeds from sale of property, plant and equipment | 18,782 | 5,196 |
| Proceeds from sale of long-term investments | 140,979 | 111,105 |
| Proceeds from sale of short-term investments | 461,882 | 336,127 |
| Net increase in loans to customers and banks | 357,629 | 310,209 |
| Net cash used in investing activities | $ (4,589,632) | $ (6,070,877) |
| **CASH FLOWS FROM FINANCING ACTIVITIES:** | | |
| Proceeds from/(principal payments on) short-term borrowings, net | 460,617 | (864,416) |
| Net increase/(decrease) in deposits from customers | 597,888 | (1,201,192) |
| Net (decrease)/increase in debt securities issued and other liabilities | (225,504) | 1,008,365 |
| Advance received for shares of SSTL (Note 16) | 602,276 | - |
| Proceeds from long-term borrowings, net of debt issuance costs | 5,459,359 | 11,638,990 |
| Proceeds from capital transactions of subsidiaries | 109,112 | - |
| Debt issuance costs | (86,522) | (174,844) |
| Principal payments on long-term borrowings | (5,302,634) | (4,390,547) |
| Principal payments on capital lease obligations | (10,420) | (8,755) |
| Acquisition of noncontrolling interests in existing subsidiaries | (787,434) | (194,233) |
| Dividends declared by subsidiaries | (823,616) | (605,477) |
| Net cash (used in)/provided by financing activities | $ (6,878) | $ 5,207,891 |
| Effects of foreign currency translation on cash and cash equivalents | $ (10,110) | $ 56,436 |
| (DECREASE)/INCREASE IN CASH AND CASH EQUIVALENTS | $ (549,868) | $ 2,878,019 |
| CASH AND CASH EQUIVALENTS, beginning of the period | 5,600,532 | 2,722,513 |
| CASH AND CASH EQUIVALENTS, end of the period * | $ 5,050,664 | $ 5,600,532 |
| CASH PAID DURING THE PERIOD FOR: | | |
| Interest, net of amounts capitalized | $ (1,643,973) | $ (1,246,503) |
| Income taxes | (987,696) | (599,907) |
| NON-CASH INVESTING AND FINANCING ACTIVITIES: | | |
| Property, plant and equipment contributed free of charge | $ 2,814 | $ 3,213 |
| Equipment acquired through vendor financing | - | 27,983 |
| Equipment acquired under capital leases | 2,567 | 179,086 |
| Amounts owed for capital expenditures | 220,790 | 285,975 |
| Payable related to business acquisitions | 23,281 | 37,985 |

| ** Cash and cash equivalents at the end of the period comprised of the following:* | | |
|---|---|---|
| *Non-banking activities* | *$ 2,265,068* | *$ 3,436,680* |
| *Banking activities* | *2,785,596* | *2,163,852* |
| | *$ 5,050,664* | *$ 5,600,532* |

See notes to consolidated financial statements.

# JSFC SISTEMA AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME
## FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009
***(Amounts in thousands of U.S. dollars, except share amounts)***

| | Share capital | | Treasury stock | | Additional paid-in capital | Retained earnings | Accumulated other compre-hensive income | JSFC Sistema's equity | Non-redeemable non-controlling interests | Total equity | Redeemable non-controlling interests |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Shares | Amount | Shares | Amount | | | | | | | |
| **Balances at January 1, 2009** | **9,650,000,000** | **30,057** | **(371,018,060)** | **(466,345)** | **2,450,496** | **3,930,143** | **(453,107)** | **5,491,244** | **3,836,573** | **9,327,817** | **237,948** |
| Accrued compensation costs | - | - | - | - | 6,287 | - | - | 6,287 | 2,934 | 9,221 | - |
| Change in fair value of noncontrolling interests | - | - | - | - | - | 4,175 | - | 4,175 | 3,320 | 7,495 | (2,395) |
| Dividends declared by subsidiaries | - | - | - | - | - | - | - | - | (587,746) | (587,746) | (12,503) |
| Acquisition of noncontrolling interests | - | - | - | - | 22,511 | - | - | 22,511 | (46,985) | (24,474) | (140,749) |
| Disposals and capital transactions of subsidiaries | - | - | - | - | (733,908) | - | 86,267 | (647,641) | 576,124 | (71,517) | - |
| Acquisition of subsidiaries | - | - | - | - | - | - | - | - | 2,552,102 | 2,552,102 | - |
| **Comprehensive income:** | | | | | | | | | | | |
| Change in fair value of interest rate swaps, net of income tax effect of $3,527 | - | - | - | - | - | - | (13,136) | (13,136) | (10,442) | (23,578) | - |
| Unrealized losses on available-for-sale securities, net of income tax effect of $nil | - | - | - | - | - | - | (2,596) | (2,596) | - | (2,596) | - |
| Unrecognized actuarial gains, net of income tax effect of $nil | - | - | - | - | - | - | 668 | 668 | 2,446 | 3,114 | - |
| Translation adjustment, net of income tax effect of $nil | - | - | - | - | - | - | 288,257 | 288,257 | 250,173 | 538,430 | (4,399) |
| Net income | - | - | - | - | - | 1,643,441 | - | 1,643,441 | 638,286 | 2,281,727 | 4,359 |
| **Total comprehensive income** | | | | | | | | **1,916,634** | **880,463** | **2,797,097** | **(40)** |
| **Balances at December 31, 2009** | **9,650,000,000** | **30,057** | **(371,018,060)** | **(466,345)** | **1,745,386** | **5,577,759** | **(93,647)** | **6,793,210** | **7,216,785** | **14,009,995** | **82,261** |
| Disposal of treasury shares | - | - | 2,845,654 | 2,612 | - | - | - | 2,612 | - | 2,612 | - |
| Accrued compensation costs | - | - | - | - | 60,629 | 336 | - | 60,965 | 757 | 61,722 | - |
| Change in fair value of noncontrolling interests | - | - | - | - | - | (6,639) | - | (6,639) | (5,479) | (12,118) | 12,118 |
| Dividends declared by subsidiaries | - | - | - | - | - | - | - | - | (838,158) | (838,158) | (14,973) |
| Dividends declared by JSFC Sistema | | - | - | - | - | (17,455) | - | (17,455) | - | (17,455) | - |
| Acquisition of noncontrolling interests | - | - | - | - | (77,699) | - | - | (77,699) | (695,950) | (773,649) | - |
| Disposals and capital transactions of subsidiaries | - | - | - | - | 372,007 | (1,371) | - | 370,636 | (576,743) | (206,107) | - |
| Acquisition of subsidiaries | - | - | - | - | - | - | - | - | - | - | 19,216 |
| **Comprehensive income:** | | | | | | | | | | | |
| Change in fair value of interest rate swaps, net of income tax effect of $(6,357) | - | - | - | - | - | - | 13,932 | 13,932 | 11,496 | 25,428 | - |
| Unrealized losses on available-for-sale securities, net of income tax effect of nil | - | - | - | - | - | - | 3,628 | 3,628 | - | 3,628 | - |
| Unrecognized actuarial gains, net of income tax effect of $nil | - | - | - | - | - | - | (2,291) | (2,291) | (5,232) | (7,523) | - |
| Translation adjustment, net of income tax effect of $7,528 | - | - | - | - | - | - | (92,771) | (92,771) | (56,487) | (149,258) | 938 |
| Net income | - | - | - | - | - | 918,697 | - | 918,697 | 1,190,719 | 2,109,416 | 7,783 |
| **Total comprehensive income** | | | | | | | | **841,195** | **1,140,496** | **1,981,691** | **8,721** |
| **Balances at December 31, 2010** | **9,650,000,000** | **30,057** | **(368,172,406)** | **(463,733)** | **2,100,323** | **6,471,327** | **(171,149)** | **7,966,825** | **6,241,708** | **14,208,533** | **107,343** |

## 1. DESCRIPTION OF THE BUSINESS AND OPERATING ENVIRONMENT

***Description of the business*** – JSFC Sistema (the "Company", together with its subsidiaries, the "Group") invests in, and manages a range of companies which operate in the telecommunications, oil and energy, high technology, banking and other sectors. The main focus of the Group's activities is service-based industries. The Company and the majority of the Company's consolidated subsidiaries are incorporated in the Russian Federation ("RF").

The controlling shareholder of JSFC Sistema is Vladimir P. Evtushenkov. Minority holdings are held by certain top executives and directors of the Group. The rest of the shares are listed on the London Stock Exchange in the form of Global Depositary Receipts (GDRs), and Russian stock exchanges.

The Group's operations are managed in four segments: Telecommunications, Technology and Industry, Consumer Assets and Oil and Energy. Below are the Group's operating segments and the principal activities of the significant entities of the Group within those segments:

| Significant Entities | Short Name | Principal Activity |
|---|---|---|
| JSFC Sistema | JSFC Sistema | Investing and financing activities |
| **Telecommunications Segment:** | | |
| MTS and subsidiaries | MTS | Wireless telecommunication services |
| Sistema Shyam TeleServices Limited | SSTL | Wireless telecommunication services |
| Sistema Mass Media and subsidiaries | SMM | Cable television, advertising, production and distribution of periodicals, movie production |
| **Consumer Assets Segment:** | | |
| Moscow Bank for Reconstruction and Development and subsidiaries | MBRD | Banking activities, securities transactions and foreign currency transactions |
| Detsky Mir-Center and subsidiaries | DM-Center | Retail and wholesale trading |
| VAO Intourist and subsidiaries | Intourist | Sale of tour packages in the RF and abroad, hotel business |
| Medsi and subsidiaries | Medsi | Healthcare services |
| **Technology and Industry Segment:** | | |
| Concern RTI Systems and subsidiaries | Concern RTI | Manufacturing of radiotechnical equipment, research and development |
| SITRONICS and subsidiaries | SITRONICS | IT and systems integration, telecommunication solutions, microelectronic solutions |
| Binnofarm and subsidiaries | Binnofarm | Production and distribution of pharmaceuticals |
| **Oil and Energy Segment:** | | |
| ANK Bashneft and subsidiaries | Bashneft | Oil and gas production |
| Bashkirenergo | Bashkirenergo | Energy production |

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

***Basis of presentation*** – The accompanying consolidated financial statements have been prepared in conformity with the accounting principles generally accepted in the United States of America ("U.S. GAAP"). The Group's entities maintain accounting records in the local currencies of the countries of their domicile in accordance with the requirements of respective accounting and tax legislation. The accompanying financial statements differ from the financial statements prepared for statutory purposes in that they reflect certain adjustments, appropriate to present the financial position, results of operations and cash flows in accordance with U.S. GAAP, which are not recorded in the accounting books of the Group's entities.

***Principles of consolidation*** – The consolidated financial statements include the accounts of JSFC Sistema, as well as entities where JSFC Sistema has operating and financial control through direct or indirect ownership of a majority voting interest. The consolidated financial statements also include accounts of variable interest entities where the Group is the primary beneficiary. All significant intercompany transactions, balances and unrealized gains and losses on transactions have been eliminated.

The beneficial ownership interest and voting interest of JSFC Sistema in the significant entities as of December 31, 2010 and 2009 are as follows:

| | Ownership interest | | Voting interest | |
|---|---|---|---|---|
| **Significant entities** | **December 31, 2010** | **December 31, 2009** | **December 31, 2010** | **December 31, 2009** |
| MTS | 55% | 55% | 55% | 55% |
| SSTL | 74% | 74% | 74% | 74% |
| SMM | 75% | 75% | 75% | 75% |
| SITRONICS | 70% | 70% | 70% | 70% |
| MBRD | 99% | 96% | 100% | 100% |
| Intourist | 66% | 66% | 66% | 66% |
| DM-Center | 75% | 100% | 75% | 100% |
| Concern RTI | 97% | 97% | 97% | 97% |
| Medsi | 100% | 100% | 100% | 100% |
| Binnofarm | 100% | 100% | 100% | 100% |
| Bashneft | 73% | 73% | 86% | 86% |
| Bashkirenergo | 31% | 31% | 50% | 50% |

***Use of estimates*** – The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses of the reporting period. Actual results could differ from those estimates.

Significant estimates for the Group include the allowance for doubtful accounts, allowances for customer loans, the valuation of assets acquired and liabilities assumed in business combinations, the recoverability of intangible assets, goodwill and other long-lived assets, valuation allowances on deferred tax assets, the valuation of asset retirement obligations, valuation of noncontrolling interests, valuation of derivative instruments, share-based compensation, and oil and gas reserves.

***Concentration of business risk*** – The Group's principal business activities are within the Commonwealth of Independent States ("CIS"), primarily in the RF and Ukraine. Laws and regulations affecting businesses operating in the RF and Ukraine are subject to rapid changes, which could impact the Group's assets and operations.

***Foreign currency*** – Management has determined that the functional currencies of the Group's subsidiaries for the year ended December 31, 2010 are the currencies of the countries of their domicile, with the exception of foreign subsidiaries of Intourist, a company incorporated in the RF, and Uzdunrobita, MTS subsidiary in Uzbekistan, whose functional currency is the U.S. dollar ("USD") due to the pervasive use of the USD in their operations.

In preparing the financial statements of the entities within the Group, transactions in currencies other than the entity's functional currency are recognized at the rates of exchange prevailing on the dates of the transactions. At each statement of financial position date, monetary assets and liabilities that are denominated in foreign currencies are retranslated at the rates prevailing at that date. Non-monetary items carried at fair value that are denominated in foreign currencies are translated at the rates prevailing at the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency, are not restated.

The Group has selected the USD as its reporting currency. The Group's assets and liabilities are translated into USD at exchange rates prevailing on the statement of financial position date. Revenues, expenses, gains and losses are translated into USD at average exchange rates prevailing during the reporting period. Equity is translated at the applicable historical rates. The resulting translation gain/(loss) is recorded as a separate component of other comprehensive income.

On the disposal of a foreign operation, all of the accumulated exchange differences in respect of that operation attributable to the Group are reclassified to profit or loss.

The official rate of exchange, as determined by the Central Bank of the RF, between RUB and USD as of December 31, 2010 was 30.48 RUB to 1 USD (30.24 RUB to 1 USD as of December 31, 2009).

***Revenue recognition*** – Generally, revenues are recognized when all of the following conditions have been met: (i) there is persuasive evidence of an arrangement; (ii) delivery has occurred; (iii) the fee is fixed and determinable; and (iv) collectability of the fee is reasonably assured.

Revenues under arrangements specific to the respective segments of the Group are recognized as follows:

**Telecommunications segment**

The Telecommunications segment of the Group earns revenues from the provisions of wireless and wireline telecommunication and data transmission services and usage of its exchange networks and facilities.

Telecommunications segment revenue consists of, and is recorded as follows:

(i) Usage charges: Revenues derived from wireless and wireline telephone usage and data transmission are recognized as the services are provided.

(ii) Monthly subscription fees: Monthly telephone and network service subscription fees are recognized in the month during which the telephone services are provided to customers.

(iii) Service activation and connection fees: Upfront fees received for installation and activation of wireless, wireline and data transmission services ("connection fees") are deferred and recognized over the expected subscriber relationship period, as follows:

| | |
|---|---|
| MTS' subscribers[1] | 12-60 months |
| Comstar UTS residential wireline voice phone subscribers | 15 years |
| Comstar UTS residential subscribers of broadband internet services | 1 year |
| Other categories of Comstar UTS' subscribers | 3-5 years |

[1] – MTS calculates an average expected term of the subscriber relationship for each region in which it operates and amortizes regional connection fees accordingly.

(iv) Revenues from use of prepaid phone cards: Revenues from prepaid phone cards are recognized in the period when the customer uses time under the phone card. Unused time on sold cards is not recognized as revenues until the related services have been provided to the customer or the card has expired.

(v) Charges for value-added telecommunication services: Revenues derived from value-added telecommunication services are recognized in the period when the services are provided to customers.

(vi) Roaming fees charged to other operators for guest roamers utilizing the segment's network: The segment charges roaming per-minute fees to other wireless operators for their subscribers utilizing the segment's networks. Revenues derived from roaming services are recognized as services are provided.

(vii) Equipment sales: The segment sells handsets and accessories to customers who enter into contracts for service and as separate distinct transactions. Revenues from the handsets and accessories are recognized when the products are delivered to and accepted by the customer, as it is considered to be a separate earnings process from the sale of wireless services. The costs of wireless handsets and accessories, whether sold to subscribers through the distribution channel or as part of the service contract, are expensed when the associated revenue is recognized.

The companies of the Group record revenues on a gross basis when several or all of the following factors apply: they are the primary obligors for providing the product or service in a transaction, they have latitude in establishing prices and selecting suppliers of services, they have credit risk related to collection of the related receivables, or they bear the risk of inventory loss. If the companies of the Group do not control the terms of the transaction or bear the risk of loss from such factors, then revenue is recognized on a net basis.

**Technology and industry segment**

Revenues under arrangements specific to respective divisions within the Technology and Industry segment are recognized as follows:

Telecommunication Solutions division

Sales of software products are generally multiple-element arrangements, involving the provision of related services, including customization, implementation and integration services, as well as ongoing support and maintenance provided to customers.

If the services element of the arrangement is deemed essential to the functionality of the software arrangement, the accounting for performance of construction-type contracts is applied, provided that the following conditions are met: (a) contracts executed by the parties normally include provisions that clearly specify the enforceable rights regarding goods or services to be provided and received by the parties, the consideration to be exchanged, and the manner and terms of settlement; (b) the buyer can be expected to satisfy its obligations under the contract; and (c) the division can be expected to perform its contractual obligations. The measurement of progress for purposes of revenue recognition is based on efforts devoted to a contract relative to total efforts required for completion.

If the services element of the arrangement is not deemed essential to the functionality of the software, the service revenues are accounted for separately from the software product revenues. In such multiple-element arrangements, the software component is accounted for using the residual method.

In cases where extended payment terms exist, license and related customization fees are recognized when payments are due, unless a history of collection, without providing concessions, has been established under comparable arrangements.

Information Technologies Solutions division

The sale of systems integration services typically includes multiple elements, such as equipment and software, installation services and post-contract support. A multiple-element arrangement is separated into more than one unit of accounting if all of the following criteria are met: (i) the delivered items have value to the customer on a standalone basis; (ii) there is objective and reliable evidence of the fair value of the undelivered items; and (iii) the arrangement includes a general right of return relative to the delivered items, delivery or performance of the undelivered items is considered probable and substantially in the control of the Group.

If evidence of the fair value of the undelivered elements of the arrangement does not exist, all revenue from the arrangement is deferred until such time that evidence of fair value does exist, or until all elements of the arrangement are delivered. Fees allocated to post-contract support are recognized as revenue on a pro rata basis over the support period. Fees allocated to other services are recognized as revenue as services are performed.

Revenue from contracts involving solutions achieved through modification of complex telecommunications equipment and software are recognized by reference to the stage of completion of the contract activity at the statement of financial position date when the outcome of a contract can be estimated reliably. This is normally measured by the proportion that contract costs incurred for work performed to date relate to the estimated total contract costs, except where this would not be representative of the stage of completion. Variations in contract work, claims and incentive payments are included to the extent that they have been agreed with the customer. Where the outcome of a contract cannot be estimated reliably, contract revenue is recognized to the extent of contract costs incurred where it is probable that such costs will be recoverable. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognized immediately.

When sale agreements provide price protection to the dealer, the revenue is deferred until the dealer sells the merchandise to a third party due to the frequent sales price reductions and rapid technology obsolescence.

Microelectronic Solutions division

The products of this division are generally sold with a limited warranty for product quality. The product return reserves and other post-contract support obligations are accrued at the time of sale. The division accrues for estimated incurred but unidentified issues based on historical activity.

**Oil and energy segment**

Oil and Gas

Revenues from the production and sale of crude oil and petroleum products are recognized when title passes to customers at which point the risks and rewards of ownership are assumed by the customer and the price is fixed and determinable. Revenues include excise taxes on petroleum products sales and duties on export sales of crude oil and petroleum products. Excise taxes, which are re-charged to third parties under the terms of processing agreements, are excluded from revenues.

Power and Utilities

The Power and Utilities division of the Oil and Energy segment of the Group earns revenue from retail and wholesale electricity and heat sales, electricity transmission and connection services. Revenue from connection services represents non-refundable upfront fees for connecting customers to the electricity grid networks. The division recognizes revenues in the financial statements as follows:

(i) Revenue from retail and wholesale electricity and heat sales is recognized upon delivery of the electricity and heat to the customer. Tariffs for electricity and heat in regulated markets are approved by the State Service on Tariffs and the Regional Energy Commission.
(ii) Revenue from electricity transmission services is recognized upon receipt of customers' acceptance of the volume of electricity transmitted. Tariffs for electricity transmission are approved by the State Service on Tariffs and the Regional Energy Commission.
(iii) Non-refundable upfront fees received are deferred and recognized over the expected customer relationship period which is approximated by the estimated useful life of the transmission equipment used to connect to the electricity grid network of 30 years. Tariffs for connection services are approved by the State Service on Tariffs and the Regional Energy Commission.

**Other businesses**

The Group's other businesses recognize revenue when products are shipped or when services are rendered to customers. In cases where the Group acts as an agent, only the net agency fee is recognized as revenue. Revenue amounts are presented net of value added taxes.

***Regulated services*** – Regulated tariff services, consisting of local telephone services and services rendered to other operators, such as traffic charges, connection fees and line rental services, provided by MGTS, the subsidiary of MTS, and energy provided by Bashkirenergo totaled approximately 9.4% and 8.0% of the consolidated revenues for the years ended December 31, 2010 and 2009, respectively. Changes in the rate structure for such services are subject to the Federal Tariff Service approval.

***Cash and cash equivalents*** – Cash and cash equivalents include cash on hand, demand deposits and other highly liquid investments with a maturity of three months or less when purchased. Cash and cash equivalents of the banking division include cash deposited with the Central Bank of the RF and other banks as well as qualifying correspondent bank accounts and/or deposits with original maturities of 90 days or less.

A reconciliation of total cash and cash equivalents and cash and cash equivalents arising from non-banking and banking activities is presented in the statement of cash flows for the years ended December 31, 2010 and 2009.

***Restricted cash*** – Cash and cash equivalents restricted by agreements with third parties for special purposes. Restricted cash as of December 31, 2010 and 2009 was $48.3 million and $51.5 million, respectively, including cash deposited by the Group to guarantee certain loans, and to be in compliance with the government regulation of local currency conversion into foreign currencies in Uzbekistan.

***Financial instruments*** – The Group's financial instruments include cash and cash equivalents, short-term investments, accounts receivable, derivative financial instruments, assets and liabilities from banking activities, accounts payable and short-term and long term debt.

The fair market value of financial instruments approximates the carrying value of these items due to the short-term nature of these amounts.

***Hedging activities*** – The Group uses derivative instruments, including swap, forward and option contracts to manage foreign currency and interest rate risk exposures. The Group reviews its fair value hierarchy classifications quarterly. Changes in significant observable valuation inputs identified during these reviews may trigger reclassification of fair value hierarchy levels of financial assets and liabilities. During the years ended December 31, 2010 and 2009 no reclassifications occurred. The fair value measurement of the Group's hedging agreements is based on the observable yield curves for similar instruments ("Level 2" of the hierarchy established by the U.S. GAAP guidance).

The Group designates derivatives as either fair value hedges or cash flow hedges in case the required criteria are met. Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the consolidated statement of operations together with any changes in the fair value of the hedged asset or liability that is attributed to the hedged risk.

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognized in accumulated other comprehensive income. The gain or loss relating to the ineffective portion is recognized immediately in the consolidated statement of operations. For derivatives that do not meet the conditions for hedge accounting, gains and losses from changes in the fair value are included in the consolidated statement of operations.

Assets and liabilities related to multiple derivative contracts with one counterparty are not offset by the Group.

The Group does not use financial instruments for trading or speculative purposes.

***Accounts receivable*** – Accounts receivable are stated at their net realizable value after deducting a provision for doubtful accounts. Such provision reflects either specific cases of delinquencies or defaults or estimates based on evidence of collectability.

***Assets from banking activities (including reclassifications and revisions)*** – Assets from banking activities comprise assets (loans, notes and others) involved in operations of the banking division.

Management of the Group determined that a segregation of the assets of its banking division, including its cash and cash equivalents, in the financial statement line items, "Assets from banking activities," (current or non-current, as relevant) would provide more transparency and a better presentation to the readers of the financial statements and therefore has made certain reclassifications to the 2009 presentation to conform with this transparency initiative.The summary of changes to the comparative information is presented below:

| | 2009 As reported | Reclassifications | 2009 As amended |
|---|---|---|---|
| Cash and cash equivalents | $ 3,845,427 | $ (408,747) | $ 3,436,680 |
| Short-term investments | 1,210,608 | (634,642) | 575,966 |
| Prepaid expenses, other receivables and other current assets, net | 1,426,794 | (68,568) | 1,358,226 |
| Assets from banking activities, current portion | 4,072,308 | 1,111,957 | 5,184,265 |
| | **$ 10,555,137** | **$ -** | **$ 10,555,137** |

In performing the presentation modifications described above, management of the Group determined that certain correspondent bank accounts and/or deposits qualifying for classification as "cash and cash equivalents – banking activities" had been omitted from the opening and closing balances of "Cash and cash equivalents" and inappropriately classified within operating activities in "Net increase in loans to customers" and "Loans to banks issued by the banking division". Additionally, cash flow fluctuations represented by certain loans in the banking division had been inadvertently classified in cash inflow/outflow from operating activities rather than investing activities in the 2009 cash flow statement.

The effect of the revisions to the 2009 cash flow statement described in the preceding paragraph is as follows:

| | 2009 As reported | Revisions | 2009 As revised |
|---|---|---|---|
| Net cash provided by operations (from "Loans to banks issued by the banking devision") | $ 3,021,926 | $ 662,643 | $ 3,684,569 |
| Net cash used in investing activities (from "Net increase in loans to customers") | (6,423,176) | 352,299 | (6,070,877) |
| Cash and cash equivalents, opening balance | 1,982,350 | 740,163 | 2,722,513 |
| Cash and cash equivalents, ending balance | 3,845,427 | 1,755,105 | 5,600,532 |

The allowance for loan losses is management's estimate of probable incurred loan losses in the lending portfolios. Additions to the allowance for loan losses are made by charges to the consolidated statement of operations. Loans deemed to be uncollectible are charged against the allowance for loan losses. Recoveries of amounts previously charged as uncollectible are credited to the allowance for loan losses.

The Group performs periodic and systematic detailed reviews of its lending portfolios to identify inherent risks and to assess the overall collectability of those portfolios. The allowance on certain homogeneous loan portfolios, which generally consist of consumer and mortgage loans, is based on an evaluation of aggregated portfolios of homogeneous loans, generally by loan type.

Loss forecast models are utilized for portfolios of homogeneous loans which consider a variety of factors including, but not limited to, historical loss experience, anticipated defaults or foreclosures based on portfolio trends, delinquencies and credit scores, and expected loss factors by loan type. The remaining loan portfolios are reviewed on an individual loan basis.

Loans subject to individual reviews are analyzed and segregated by risk according to the Group's internal risk rating scale. These risk classifications, in conjunction with an analysis of historical loss experience, current economic conditions and performance trends within specific portfolio segments, and any other pertinent information result in the estimation allowances for loan losses. An allowance for loan losses is established for individually impaired loans. A loan is considered impaired when, based on current information and events, it is probable that the Group will be unable to collect all amounts due, including principal and interest, according to the contractual terms of the agreement. Individually impaired loans are measured based on the present value of payments expected to be received, or for loans that are solely dependent on the collateral for repayment, the estimated fair value of the collateral. If the recorded investment in impaired loans exceeds the measure of estimated fair value, an allowance is established as a component of the allowance for loan losses.

***Non-accrual loans*** – In general, the accrual of interest on commercial loans is discontinued at the time the loan is 90 days delinquent unless the credit is well secured and in process of collection. In all cases, loans are placed on non-accrual, or written-off at an earlier date, if collection of principal or interest is considered doubtful. All interest earned but not collected for loans that are placed on non-accrual or written-off is reversed against interest income. Loans are returned to accrual status when all the principal and interest amounts contractually due are reasonably assured of repayment within a reasonable time frame and when the borrower has demonstrated payment performance of cash or equivalents for a minimum of six months.

***Inventories and spare parts*** – Inventories, including spare parts, are stated at the lower of cost or market value.

SITRONICS' Information Technologies Solutions products and the cost of MTS's inventories (including mostly spare parts) is computed on a weighted average cost basis. The cost of other inventories of the Group are recorded at weighted average or the first-in, first-out ("FIFO").

The cost of raw materials includes the cost of purchase, customs duties, transportation and handling costs. Work in-progress and finished goods are stated at production cost which includes direct production expenses and manufacturing overheads. Costs and estimated earnings in excess of billings on uncompleted contracts include the accumulated costs of projects contracted with third parties, net of related progress billings. The entities of the Group periodically assess their inventories for obsolete or slow moving stock.

***Value-added taxes*** – Value-added taxes ("VAT") related to sales are payable to the tax authorities on an accrual basis based upon invoices issued to the customer. VAT incurred for purchases may be reclaimed, subject to certain restrictions, against VAT related to sales. VAT related to purchase transactions has not reclaimed as of the statement of financial position dates are recorded as VAT receivable in the accompanying financial statements.

***Property, plant and equipment*** – For subsidiaries acquired by the Group through business combinations, property, plant and equipment ("PP&E") were assigned their fair values at the acquisition date. If fair values of the identifiable net assets of the acquired entities exceeded acquisition cost, the fair values of non-current assets held by the acquired entities at the acquisition date, including PP&E, were reduced by such excess. All subsequent additions to PP&E have been recorded at cost.

Cost includes major expenditures for improvements and replacements, which extend useful lives of the assets or increase their revenue generating capacity. Repairs and maintenance are charged to the consolidated statement of operations as incurred.

The Group recognizes the costs of overhauls and preventive maintenance performed with respect to oil refining assets as expenses when incurred. Cost of major overhauls and replacements, which extend useful lives of the assets or increase their revenue generating capacity are capitalized to the cost of the assets.

Depreciation for property, plant and equipment other than depletion on oil and gas properties is computed under the straight-line method utilizing estimated useful lives of the assets as follows:

| | |
|---|---|
| Buildings | 20-50 years |
| Leasehold improvements | Lesser of the estimated useful life or the term of the lease |
| Switches and transmission devices | 7-31 years |
| Network and base station equipment | 4-12 years |
| Refining, marketing, distribution and chemicals | 3-40 years |
| Exploration and production assets | 3-19 years |
| Power and utilities | 3-47 years |
| Other plant, machinery and equipment | 3-25 years |

Depletion expense of proved oil and gas properties is calculated using the unit-of-production method based on total proved reserves. Depletion expense of other capitalized costs related to oil and gas production is calculated using the unit-of-production method based on proved developed reserves.

Capital leases are recorded at the lower of the fair market value of the asset or the present value of future minimum lease payments. The discount rate used in determining the present value of the minimum lease payments is the Group's incremental borrowing rate, unless (1) it is practicable to determine the implicit rate computed by the lessor; and (2) the implicit rate is less than the Group's incremental borrowing rate. If both of those conditions are met, the interest rate implicit in the lease is used.

Items of property, plant and equipment that are retired or otherwise disposed of are eliminated from the consolidated statement of financial position along with the corresponding accumulated depreciation. Any gain or loss resulting from such retirement or disposal is included in the determination of consolidated net income.

Construction in-progress and telecommunications equipment for installation are not depreciated until an asset is placed into service.

***Transportation expenses*** – Transportation expenses represent all expenses incurred in the transportation of crude oil and petroleum products via the Transneft pipeline network, as well as by railway and other transportation means. Transportation expenses also include all other shipping and handling costs.

***Asset retirement obligations*** – The Group calculates an asset retirement obligation and an associated asset retirement cost when the Group has a legal or constructive obligation in connection with the retirement of tangible long-lived assets.

As of December 31, 2010 and 2009, the estimated present value of the Group's asset retirement obligations and change in liabilities were as follows:

| | | Telecom-munications | Oil and Energy | Total |
|---|---|---|---|---|
| Balance as of January 1, 2009 | $ | 62,053 | - | 62,053 |
| Liabilities incurred in the current period | | 3,923 | 1,924 | 5,847 |
| Business combinations | | - | 92,044 | 92,044 |
| Accretion expense | | 6,518 | 9,611 | 16,129 |
| Revisions in estimated cash flows | | 17,693 | - | 17,693 |
| Currency translation adjustment | | (1,504) | (2,772) | (4,276) |
| **Balance as of December 31, 2009** | **$** | **88,683** | **100,807** | **189,490** |
| Liabilities incurred in the current period | | 4,066 | 1,745 | 5,811 |
| Business combinations | | - | - | - |
| Accretion expense | | 9,776 | 11,969 | 21,745 |
| Revisions in estimated cash flows | | (23,813) | 82,547 | 58,734 |
| Currency translation adjustment | | (673) | (1,191) | (1,864) |
| **Balance as of December 31, 2010** | **$** | **78,039** | **195,877** | **273,916** |
| Current portion | | - | 15,534 | 15,534 |
| Long-term portion | | 78,039 | 180,343 | 258,382 |
| **Balance as of December 31, 2010** | **$** | **78,039** | **195,877** | **273,916** |

The Group's obligations in Telecommunication segment relate primarily to the cost of removing its equipment from sites. The obligation in Oil and Energy segment relate primarily to the cost of decommissioning wells, dismantling equipment, restoring the sites and performing other related activities.

The Group recorded the long-term portion of the present value of assets retirement obligations as a part of long-term liabilities in the consolidated statements of financial position as of December 31, 2010 and 2009 and the current portion of Group's obligation was included as a component of accrued expenses and other current liabilities. Revisions in estimated cash flows are attributable to the change in the estimated future useful life of the assets.

***Business combinations*** – Acquisition of businesses from third parties is accounted for using the acquisition method. On acquisition, the assets and liabilities of an acquired entity are measured at their fair values as at the date of acquisition. The noncontrolling interest arising in the acquisitions for which the acquisition date was before January 1, 2009 is stated at the noncontrolling interest's proportion of the book values of the assets and liabilities recognized. The noncontrolling interest arising in the acquisitions for which the acquisition date was January 1, 2009 and thereafter is stated at the noncontrolling interests' proportion of the fair values of the assets and liabilities recognized.

The Group accounted for the acquisition of the noncontrolling interests which occurred before January 1, 2009 using the purchase method. As a result of each step acquisition, the historical cost basis of the noncontrolling interest balance was reduced to the extent of the interest acquired, and the increased ownership obtained was accounted for by increasing the acquired entity's basis from historical cost to fair value for the portion of the assets acquired and liabilities assumed based on the additional ownership acquired. Acquisitions of the noncontrolling interests which occurred on or after January 1, 2009 are accounted for as equity transactions.

***Goodwill*** – Goodwill arising on acquisitions is recognized as an asset and initially measured at cost.

For the acquisitions for which the acquisition date was before January 1, 2009, goodwill is determined as the excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognized, and the excess of the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities over the cost of the business combination is allocated on a pro-rata basis to decrease the value of certain long-term assets.

For the acquisitions where the acquisition date was January 1, 2009 and thereafter, goodwill is determined as the excess of the consideration transferred plus the fair value of any noncontrolling interest in the acquiree at the acquisition date over the fair values of the identifiable net assets acquired. The excess of the fair values of the identifiable net assets acquired over the cost of the business combination plus the fair value of any noncontrolling interest in the acquiree at the acquisition date is credited to income.

Goodwill is not amortized to operations, but instead is reviewed for impairment at least annually Goodwill is reviewed for impairment by comparing the carrying value of each reporting unit's net assets (including allocated goodwill) to the fair value of the reporting unit. If the reporting unit's carrying amount is greater than its fair value, a second step is performed whereby implied fair value that relates to the reporting unit's goodwill is compared to the carrying value of the reporting unit's goodwill. The Group recognizes a goodwill impairment charge for the amount by which the carrying value of goodwill exceeds the fair value. The Group has determined that there are no impairment losses in respect of goodwill for the reporting periods covered by these consolidated financial statements

***Other intangible assets*** – License costs are capitalized as a result of (a) the purchase price allocated to licenses acquired in business combinations; and (b) licenses purchased directly from government organizations, which require license payments.

License costs are being amortized during the initial license period without consideration of possible future renewals, subject to periodic review for impairment, on a straight-line basis over the period of validity which is from three to fifteen years.

Acquired customer bases are amortized over the estimated average subscriber life from 12 to 96 months. Deferred telephone numbering capacity costs with limited contractual life are being amortized over their contractual lives, which vary from 5 to 20 years. Acquired radio frequencies are amortized over the estimated average life of 96 months. Software costs and other intangible assets are being amortized over 3 to 10 years. All finite-life intangible assets are being amortized using the straight-line method.

Other intangible assets represent trademarks, telephone numbering capacity, radio frequencies and various purchased software costs. Trademarks and telephone numbering capacity with unlimited contractual life are not amortized, but are reviewed, at least annually, for impairment. If the fair value of the intangible asset is less than its carrying value, an impairment loss is recognized in an amount equal to the difference. The Group also evaluates the remaining useful life of its intangible assets that are not subject to amortization on an annual basis to determine whether events and circumstances continue to support an indefinite useful life. If an intangible asset that is not being amortized is subsequently determined to have a finite useful life, that asset is tested for impairment. After recognition of the impairment, if any, the asset is amortized prospectively over its estimated remaining useful life and accounted for in the same manner as other intangible assets that are subject to amortization.

***Investments*** – The Group's share in the net assets and net income of certain entities, where the Group holds 20% to 50% of voting shares and has the ability to exercise significant influence over their operating and financial policies ("affiliates") is included in the consolidated net assets and operating results using the equity method of accounting. The Group's share in the net income of affiliates where the Group has day-to-day involvement in business activities and which are integral to the Group's business is recorded within operating income. In other cases, the Group's share in net income is shown after the income tax provision. Other-than-temporary decreases in the value of the investment in affiliates are recognized in net income.

All other equity investments, which consist of investments for which the Group does not have the ability to exercise significant influence, are accounted for under the cost method or at fair value. Investments in private companies are carried at cost, less provisions for other-than-temporary impairment in value. For public companies that have readily determinable fair values, the Group classifies its equity investments as available-for-sale or trading. For available for sale securities, the Group records these investments at their fair values with unrealized holding gains and losses included in the consolidated statement of changes in shareholder's equity and comprehensive income, net of any related tax effect. For trading securities, the Group records the investment at fair value. Unrealized holding gains and losses for trading securities are included in earnings.

The Group purchases promissory notes for investing purposes. These notes are carried at cost and the discount against the nominal value is accrued over the period to maturity. A provision is made, based on management assessment, for notes that are considered uncollectible. The notes are classified as held-to-maturity.

Investments which are expected to be realized within twelve months after the statement of financial position date are classified as short-term investments. Other investments are classified as long-term investments.

***Debt issuance costs*** – Debt issuance costs are recorded as an asset and amortized using the effective interest method over the terms of the related loans.

***Impairment of long-lived assets other than goodwill and indefinite-lived intangible assets*** – The Group periodically evaluates the recoverability of the carrying amount of its long-lived assets. Whenever events or changes in circumstances indicate that the carrying amounts of those assets may not be recoverable, the Group compares the undiscounted net cash flows estimated to be generated by those assets to the carrying amount of those assets. When these undiscounted cash flows are less than the carrying amounts of the assets, the Group records impairment losses to write the asset down to fair value, measured by the estimated discounted net future cash flows expected to be generated from the use of the assets.

***Liabilities from banking activities*** – Liabilities from banking activities include deposits from banks and customers, promissory notes issued and other liabilities that arise out of operations of the banking division.

***Property, plant and equipment contributions*** – Telecommunication equipment and transmission devices, installed at newly constructed properties in Moscow, have been historically transferred to MGTS, a fixed line operator and subsidiary of the Group, by the Moscow City Government free of charge. These assets are capitalized by the Group at their market value at the date of transfer. Simultaneously, deferred revenue is recorded in the same amount and is amortized as a reduction of the depreciation charge in the consolidated statement of operations over the contributed assets' life.

***Income taxes*** – Income taxes of the Group's Russian entities have been computed in accordance with RF laws. The corporate income tax rate in the RF was 20% in 2010 and 2009. The income tax rate on dividends paid within Russia is 9%. The foreign subsidiaries of the Group are paying income taxes in their jurisdictions.

Deferred tax assets and liabilities are recognized for differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the tax bases of assets and liabilities that will result in future taxable or deductible amounts. The deferred tax assets and liabilities are measured using the enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. In making such determination, we consider all available positive and negative evidence, including future reversals of existing taxable temporary differences, projected future taxable income, tax planning strategies and recent financial operations.

The Group intends to reinvest the unremitted earnings of certain of its subsidiaries. Accordingly, no provision has been made for taxes with respect to these earnings. In the event of their distribution, in most cases such earnings would be subject to income taxes.

Uncertain tax positions are recognized in the consolidated financial statements for positions which are considered more likely than not of being sustained based on the technical merits of the position on audit by the tax authorities. The measurement of the tax benefit recognized in the consolidated financial statements is based upon the largest amount of tax benefit that, in management's judgment, is greater than 50% likely of being realized based on a cumulative probability assessment of the possible outcomes.

The Group recognizes interest relating to unrecognized tax benefits and penalties within income taxes.

***Treasury stock*** – If the Group reacquires its own equity instruments, those instruments ("treasury shares") are recognized as a deduction of equity at cost, being the consideration paid to reacquire the shares. No gain or loss is recognized in profit or loss on the purchase, sale, issue or cancellation of the Group's own equity instruments. Such treasury shares may be acquired and held by JSFC Sistema or by other subsidiaries of the Group.

***Stock-based compensation*** – The Group calculates and records the fair value of equity instruments, such as stock options or restricted stock, awarded to employees for services received and recognizes such amounts in the consolidated statement of operations. The fair value of the equity instruments is measured on the date they are granted and is recognized over the period during which the employees are required to provide services in exchange for the equity instruments (Note 24). Stock-based compensation expense includes the estimated effects of forfeitures. Such estimates are adjusted over the requisite service period to the extent actual forfeitures differ, or are expected to differ from such estimates. Changes in estimated forfeitures are recognized in the period of change and also impact the amount of expense to be recognized in future periods.

***Retirement and postretirement benefits*** – Subsidiaries of the Group contribute to the local state pension funds and social funds, on behalf of their employees.

Since January 1, 2010, Unified social tax ("UST") was substituted with social contributions calculated by the application of following rates: 26% – for the accumulated personal income up to RUB 415,000, 0% for the personal earnings above stated amount. Social contributions are allocated to three social funds, including the pension fund, where the rate of contributions to the pension fund was 20%. The contributions are expensed as incurred.

In Ukraine, the subsidiaries of the Group are required to contribute a specified percentage of each employee's payroll up to a fixed limit to a pension fund, an unemployment fund and a social security fund. The contributions are expensed as incurred.

In addition, Intracom Telecom and MGTS have defined benefit plans to provide their employees certain benefits upon and after retirement. The net period cost of the Group's defined benefit plans is measured on an actuarial basis using the projected unit credit method and several actuarial assumptions. The recognition of expense for retirement pension plans is significantly impacted by estimates made by management such as discount rates used to value certain liabilities, expected return on assets, mortality rates, future rates of compensation increase and other related assumptions. Gains and losses occur when actual experience differs from actuarial assumptions. If such gains or losses exceed ten percent of the greater of plan assets or plan liabilities the Group amortizes those gains or losses over the average remaining service period of the employees.

The Group records on the statement of financial position the funded status of its pension plans based on the projected benefit obligation.

***Borrowing costs*** – Borrowing costs are recognized as an expense in the period in which they are incurred. Borrowing costs for assets that require a period of time to get them ready for their intended use are capitalized and amortized over the related assets' estimated useful lives. The capitalized borrowing costs for the year ended December 31, 2010 and 2009 amounted to $46.4 million and $87.5 million, respectively.

***Advertising costs*** – Advertising costs are expensed as incurred. Advertising costs for the year ended December 31, 2010 and 2009 were $417.3 million and $440.7 million, respectively, and were reflected as a component of selling, general and administrative expenses in the accompanying consolidated statements of operations.

***Research and development costs*** – Research and development ("R&D") costs are fully charged to the consolidated statements of operations when incurred and for the year ended December 31, 2010 and 2009, equaled $18.7 million and $21.3 million, respectively. Such costs were reflected as a component of selling, general and administrative expenses in the accompanying consolidated statements of operations.

***Taxes other than income tax*** – Taxes other than income tax comprise excises, mineral reserve tax and customs, which relate to the Oil and Energy segment, and other taxes. The mineral extraction tax of $1,108.3 million, excise taxes of $671.4 million, export duties of $2,081.3 million were recorded in the year ended December 31, 2010 compared to $609.1 million, $193.5 million and $563.5 million in 2009 respectively.

***Redeemable noncontrolling interests*** – From time to time to optimize the structure of business acquisitions and to defer payment of the purchase price the Group enters into put and call option agreements to acquire noncontrolling stake in the existing subsidiary which are not considered freestanding financial instruments as they were entered into in connection with other equity transactions.Therefore, the put and call option agreements in combination with the underlying noncontrolling interest are considered a single unit of account and are accounted for as "Redeemable noncontrolling interest" at redemption value which is generally the fair value of redeemable noncontrolling interests as of reporting date.

Fair value of redeemable noncontrolling interests is assessed based on discounted future cash flows of the acquired entity ("Level 3" significant unobservable Inputs of the hierarchy established by the US GAAP guidance). Changes in redemption value of redeemable noncontrolling interests are accounted for in the Group's retained earnings. Redeemable noncontrolling interests are presented as temporary equity in the consolidated statement of financial position.

As of December 31, 2010 redeemable noncontrolling interests outstanding consist of $86.9 million attributable to MTS' subsidiaries and $20.4 million attributable to M2M Telematics shares.
As of December 31, 2009 redeemable noncontrolling interests outstanding of $82.3 million are attributable to MTS' subsidiaries.

***Earnings per share*** – Basic earnings per share ("EPS") have been determined using the weighted average number of shares outstanding during the year ended December 31, 2010 and 2009.

Diluted EPS reflect the potential dilution related stock options granted to employees. The diluted weighted average number of shares and diluted EPS were not different from basic for the years ended December 31, 2010 and 2009.

***Distributions to shareholders*** – Distributable retained earnings of the Group are based on amounts extracted from the statutory accounts of JSFC Sistema and may significantly differ from amounts calculated on the basis of U.S. GAAP.

***Reclassifications*** – Certain comparative information presented in the consolidated financial statements for the year ended December 31, 2009 has been reclassified in order to achieve comparability with the presentation used in the consolidated financial statements for the year ended December 31, 2010.

**Recent accounting pronouncements**

***Adopted during the year***

In June 2009, the FASB updated the guidance related to consolidation accounting for variable interest entities to require an enterprise to perform an analysis to determine whether the entity's variable interest or interests give it a controlling interest in a variable interest entity. The adoption of this guidance, effective January 1, 2010, did not have an impact on the Group's consolidated financial statements.

***To be adopted in future periods***

In October 2009, FASB issued Accounting Standards Update ("ASU") No. 2009-14, "Software" (Topic 985): Certain Revenue Arrangements That Include Software Elements-a consensus of the FASB Emerging Issues Task Force, that amends Subtopic 985-605, "Software: Revenue Recognition". The Update excludes from the scope of Accounting Standards Codification ("ASC") 985-605 certain tangible products that contain software that functions together with nonsoftware deliverables to deliver the tangible product's essential functionality. The ASU does not create any new methods of revenue recognition, but its amendments to the scope of existing guidance can significantly affect an entity's periodic revenue. The amendments in the Update are effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted. The Group is currently evaluating the potential impact of this ASU on the Group's consolidated financial statements.

In October 2009, the FASB amended the revenue recognition for multiple deliverable arrangements guidance to require the use of the relative selling price method when allocating revenue in these types of arrangements. This method allows a vendor to use its best estimate of selling price if neither vendor specific objective evidence nor third party evidence of selling price exists when evaluating multiple deliverable arrangements. This updated guidance is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. The adoption of this guidance, effective January 1, 2011, is not expected to have a significant impact on the Group's consolidated financial statements.

In January 2010, the FASB issued additional guidance that requires new disclosures related to transfers into and out of Level 1 and Level 2 of fair value measurements and separate presentation of information about purchases, sales, issuances, and settlements in the roll forward for Level 3 inputs. The update also clarifies existing guidance for fair value measurements for each class of assets and liabilities as well as for disclosures about inputs and valuation techniques. The guidance is effective for interim and annual periods beginning after December 15, 2009, except for the disclosures related to purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements, which are effective for interim and annual periods beginning after December 15, 2010. The adoption of the revised guidance will impact disclosures in the Group's consolidated financial statements.

In March 2010, the FASB issued ASU 2010-11 Derivatives and Hedging Topic 815 "Scope Exception Related to Embedded Credit Derivatives." This ASU clarifies the guidance within the derivative literature that exempts certain credit related features from analysis as potential embedded derivatives requiring separate accounting. The ASU specifies that an embedded credit derivative feature related to the transfer of credit risk that is only in the form of subordination of one financial instrument to another is not subject to bifurcation from a host contract under ASC 815-15-25, Derivatives and Hedging – Embedded Derivatives – Recognition. All other embedded credit derivative features should be analyzed to determine whether their economic characteristics and risks are "clearly and closely related" to the economic characteristics and risks of the host contract and whether bifurcation is required. The ASU is effective for the Group on July 1, 2010. The Group does not expect the provisions of ASU 2010-17 to have a material effect on the consolidated financial position, results of operations or cash flows of the Group.

In April 2010, the FASB issued ASU 2010-17, Revenue Recognition-Milestone Method (Topic 605): Milestone Method of Revenue Recognition. The amendments in this Update are effective on a prospective basis for milestones achieved in fiscal years, and interim periods within those years, beginning on or after June 15, 2010. The Group does not expect the provisions of ASU 2010-17 to have a material effect on the consolidated financial position, results of operations or cash flows of the Group.

In April 2010, the FASB issued an amendment to its stock-based compensation guidance to clarify that employee stock options that have exercise prices denominated in the currency of any market in which a substantial portion of the entity's securities trade should be classified as equity, assuming all other criteria for equity classification are met. The amendment is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2010. The Group does not expect the provisions of the amendment to have any effect on its consolidated financial statements.

In December 2010, the FASB issued guidance on disclosure of supplementary pro forma information for business combinations which states that when a public entity's business combinations are material on an individual or aggregate basis, the notes to its financial statements must provide pro forma revenue and earnings of the combined entity as if the acquisition date(s) had occurred as of the beginning of the annual reporting period. It clarifies that if comparative financial statements are presented, the pro forma disclosures for both periods presented (the year in which the acquisition occurred and the prior year) should be reported as if the acquisition had occurred as of the beginning of the comparable prior annual reporting period only and not as of it had occurred at the beginning of the current annual reporting period. It is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 15 December 2010, and should be applied prospectively.

In December 2010, the FASB issued additional guidance which does not prescribe a specific method of calculating the fair value of a reporting unit in the performance of step 1 of the goodwill impairment test and requires entities with a zero or negative carrying value to assess, considering qualitative factors, whether it is more likely than not that a goodwill impairment exists. If an entity concludes that it is more likely than not that goodwill impairment exists, the entity must perform step 2 of the goodwill impairment test. It is effective for the impairment tests performed during entities' fiscal years (and interim periods within those years) that begin after December 15, 2010. Early application is not permitted. The Group does not expect the provisions of the amendment to have significant impact on its consolidated financial statements.

## 3. ACQUISITIONS

### Acquisitions 2010

OJSC M2M Telematics

In July 2010 the Group acquired a 51% controlling stake in OJSC M2M Telematics for a total cash consideration of $20 million. The Group has an option to acquire the remaining 49% stake in the next two to five years. The purchase price allocation for the acquisition was as follows:

| | | |
|---|---|---|
| Other non-current assets | $ | 39,216 |
| Noncontrolling interest | | (19,216) |
| **Cash consideration paid** | **$** | **20,000** |

M2M Telematics is the leader in the Russian market of transport monitoring, navigation and telematics based on GLONASS/GPS technologies. The company has a broad portfolio of products for multiple market segments which it sells through an extensive distribution network comprising 56 regional partners to a large customer base.

CJSC Multiregion

In July 2010 MTS acquired a 100% stake in CJSC Multiregion, one of the leading groups of broadband and cable TV providers in the Russian regions, from Cavolo Trading Limited (Cyprus). The purchase price amounts to $123.6 million. MTS will also assume debts totaling $94.4 million. The provisional amounts for the transaction were as follows:

| | | |
|---|---|---|
| **Current assets** | **$** | **46,778** |
| Non-current assets | | 46,732 |
| Customer base | | 76,376 |
| Goodwill | | 148,743 |
| Current liabilities | | (126,780) |
| Non-current liabilities | | (44,007) |
| Fair value of noncontrolling interest | | (24,246) |
| **Cash consideration paid** | **$** | **123,596** |

The fair value of the noncontrolling interests was determined based on unobservable inputs ("Level 3" from the fair value hierarchy). The fair value of Multiregion's net assets was measured using the discounted future cash flows which were further adjusted for the lack of control and lack of liquidity.

The excess of the purchase price over the value of net assets acquired was allocated to goodwill which was assigned to the Telecommunication segment and is not deductible for income tax purposes. Goodwill is mainly attributable to the synergies from reduction of internet-traffic and administrative expenses of the MTS and expected increase of market share as a result of future capital expenditures to be made by the MTS.

Sky Link

In November 2009, the Group and Svyazinvest ("the Parties") signed a non-binding memorandum of understanding ("MOU"), under which the Parties agreed to enter in a series of transactions which would ultimately result in (i) the disposal of the Group's investment in Svyazinvest to a state-controlled enterprise; (ii) non-cash extinguishment of the Group's indebtedness to Sberbank; (iii) an increase in the Group's ownership in Sky Link from 50.0% to 100.0% and disposal of this 100% investment to Svyazinvest; and (iv) the disposal of 28% of MGTS' common stock previously owned by Svyazinvest to the Group.

In April 2010 the Group raised its effective equity stake in Sky Link by 50.0% to 100.0%. This 100% stake had previously been agreed to be disposed of as a part of the transaction with Svyazinvest (see above), and was therefore classified as an asset held for sale upon the date of the Group acquiring 100% ownership. The purchase price allocation for the acquisition was as follows:

| | | |
|---|---|---|
| Current assets | $ | 47,640 |
| Non-current assets | | 541,267 |
| Current liabilities | | (135,248) |
| Non-current liabilities | | (136,873) |
| Fair value of the Group's investments as of the date of acquisition | | (148,263) |
| **Cash consideration paid** | **$** | **168,523** |

In July 2010, the Group and Svyazinvest signed an exchange agreement where the parties agreed to exchange their stakes in MGTS and Sky Link under certain conditions.

According to the share exchange agreement, Svyazinvest agreed to transfer to the Group 28.0% of ordinary shares in MGTS (23.3% of the share capital of MGTS), in exchange for Group's 100% stake in Sky Link. Furthermore, the Group was to make an additional cash payment of RUB 450 million to Svyazinvest to cover the difference in value of MGTS and Sky Link shares, and the new shareholders of Sky Link agreed to settle its obligations to the Group in the total amount of approximately $307.4 million. As a result of the transaction the Group recognized a gain on disposal amounting to $324.7 million.

Upon completion of the transaction, the Group's stake in MGTS increased to 93.3% and the noncontrolling interests attributable to MGTS decreased by $410.3 million, with corresponding increase in additional paid-in capital of $86.0 million.

Acquisition of noncontrolling interests

In September 2010, through voluntary tender offer MTS acquired 37,614,087 ordinary Comstar-UTS shares, or approximately 9.0% of Comstar-UTS' issued share capital, for a total cost of RUB 8.28 billion (approximately $271.89 million as of October 6, 2010). This brings MTS' total ownership stake in Comstar-UTS to 70.97% of Comstar-UTS' issued share capital (or 73.33% excluding treasury shares). The transaction was accounted for directly in equity.

In October 2010, MBRD issued additional shares, which were all purchased by the Group. As a result of transaction, the Group's share in MBRD increased to 99.3%. The transaction was accounted for directly in equity and resulted in a decrease in the noncontrolling interest of $12.5 million.

In February-April 2010, Bashneft made mandatory offers to acquire noncontrolling interests in Ufimsky Refinery, Ufaorgsintez, Ufaneftekhim, Novoil and Bashkirnefteproduct. As a result of subsequent purchases of noncontrolling interests the Group's ownership in these entities increased by 0.51%, 3.67%, 5.64%, 0.51% and 0.15% respectively for a total cash consideration of $128.1 million. These transactions were accounted for directly in equity and resulted in the decrease in noncontrolling interests by $119.1 million.

In April 2010, Bashneft acquired 25% of shares of Sistema-Invest, a subsidiary of the Group, for a cash consideration of $205 million. As a result of acquisition the Group's stake in Sistema-Invest increased to 90%. In December 2010 the Group's increased its stake in Sistema-Invest to 100% for a cash consideration $120 million. The transactions in April and December 2010 were accounted for directly in equity and resulted in the decrease in noncontrolling interest by $245.7 million and by $35 million, respectively.

Other acquisitions

Below are the other individually insignificant acquisitions for the year ended December 31, 2010:

| | For the year ended December 31, 2010 | | | | | |
|---|---|---|---|---|---|---|
| | | | Ownership interest | | | Purchase |
| Acquiree | Principal activity | Date of acquisition | Before acquisition | After acquisition | Acquiring segment | price (in $ million) |
| Tenzor Telecom | Fixed line and Internet services | February 2010 | 0% | 100% | Telecom-munications | 6.2 |
| Penza Telecom | Fixed Line and internet services | May 2010 | 0% | 100% | Telecom-munications | 19.3 |
| Serebryany Bor LLC | Rentering a building | October 2010 | 0% | 100% | Consumer Assets | 5.9 |
| Sweet-com | Telematic communication | June 2010 | 74.9% | 100% | Telecom-munications | 8.5 |
| Lank Telecom | Fixed line and Internet services | December 2010 | 0% | 100% | Telecom-munications | 17.8 |
| NMSK | Fixed line and Internet services | December 2010 | 0% | 100% | Telecom-munications | 23.2 |
| Smart Technology | Information Technologies Solutions | April 2010 | 65% | 100% | Technology | 3.5 |
| **Total** | | | | | | **$ 84.4** |

As a result of the purchase price allocation related to other acquisitions, the Group assigned $32.2 million to the goodwill and $39.5 to the subscriber base.

Pro forma results of operations (unaudited)

The following pro forma financial data for the years ended December 31, 2010 and 2009, give effect to the acquisitions of Serebryany Bor LLC, OJSC M2M Telematics, CJSC Multiregion, Tenzor Telecom, Penza Telecom, Lank Telecom and NMSK as if they had occurred as of January 1, 2009:

| | Year ended December 31, | |
|---|---|---|
| | **2010** | **2009** |
| Revenues | $ 28,172,167 | $ 18,840,780 |
| Net income | 913,343 | 1,611,570 |

The pro forma information is based on various assumptions and estimates. The pro forma information is not necessarily indicative of the operating results that would have occurred if the Group's acquisitions had been consummated at the beginning of the respective period, nor is it necessarily indicative of future operating results. The pro forma information does not give effect to any potential revenue enhancements or cost synergies or other operating efficiencies that could result from the acquisitions.

***Acquisitions 2009***

Oil and energy companies in the Republic of Bashkortostan

In April 2009, the Group increased its share in oil and energy companies in the Republic of Bashkortostan to controlling stakes for a total cash consideration of $2.0 billion. As a result of this transaction, the Group increased its stakes to a 76.5% stake in ANK Bashneft, a 65.8% stake in Ufaneftekhim, a 87.2% stake in Novoil, a 73.0% stake in Ufaorgsintez, a 78.5% stake in UNPZ and a 73.3% stake in BNP and acquired control over Bashkirenergo since ANK Bashneft, Ufaneftekhim, Novoil and UNPZ's aggregated stake in ordinary shares of Bashkirenergo is 50.2%.

The business combination was accounted for by using the acquisition method.

The purchase price allocation for the acquisition was as follows:

| | |
|---|---|
| Current assets | $ 1,416,325 |
| Property, plant and equipment | 8,754,709 |
| Other non-current assets | 367,892 |
| Current liabilities | (1,030,318) |
| Non-current liabilities | (205,128) |
| Deferred taxes | (984,986) |
| Noncontrolling interest | (2,552,102) |
| **Net assets acquired** | **5,766,392** |
| Carrying value of the Group's investments in energy companies in the Republic of Bashkortostan as of the date of acquisition | (983,557) |
| Gain on acquisition | (2,782,835) |
| **Cash consideration paid** | **$ 2,000,000** |

Eurotel acquisition

In December 2009, MTS acquired a 100% stake in Eurotel OJSC ("Eurotel"), a Russian federal provider of fixed line communication services, from Mortfield Holdings Limited (Cyprus). The purchase price amounted to $110.0 million with a portion payable by the end of February 2011 should the company satisfy certain conditions set forth in the purchase agreement. At the acquisition date the estimated fair value of this contingent consideration was $20.0 million.

Eurotel has an extensive optical fiber network of 19.5 thousand km, which connects approximately 20 major cities in Russia. As a result of the combination, MTS' network extends up to 35 thousand km.

The acquisition was accounted for using the acquisition method. The purchase price allocation for the acquisition was as follows:

| | |
|---|---|
| Current assets | $ 14,300 |
| Non-current assets | 67,960 |
| Customer base | 4,726 |
| Goodwill | 98,542 |
| Liabilities | (75,528) |
| Fair value of contingent consideration | (20,000) |
| **Cash consideration paid** | **$ 90,000** |

Goodwill is mainly attributable to the synergies from reduction of interconnect and internet-traffic expenses of MTS. Goodwill is not deductable for income tax purposes and was assigned to the "Telecommunications" segment.

Acquisitions of nonredeemable and redeemable noncontrolling interests

In October 2009, JSFC Sistema made a mandatory offer of RUB 286.5 per ordinary share to the shareholders of Bashneft to acquire outstanding shares. As a result of the offer, the Group's ownership in Bashneft increased by approximately 1.2% for a total cash consideration of $23 million. The transaction was accounted for directly in equity and resulted in the decrease in noncontrolling interests by $45.5 million.

In July 2009 redeemable noncontrolling interests outstanding attributable to SITRONICS shares were redeemed for a total cash consideration of $96.6 million. The transaction was accounted for directly in equity and resulted in the decrease in redeemable noncontrolling interests of $97.3 million.

In January 2009, Glaxen Corp. ("Glaxen"), the noncontrolling shareholder of Dagtelecom, exercised its put option over its 25.5% stake in the company. Consideration payable by the Group on the put option agreement comprised $51.3 million. Payment made by the Group was reduced by $12.5 million to offset the loan receivable from Glaxen at the date of acquisition. The transaction was accounted for as a decrease in redeemable noncontrolling interests of $43.4 million.

In March 2008, SITRONICS purchased a 49.0% stake in its subsidiary, SITRONICS IT B.V. (previously – Kvazar-Micro Corporation B.V.) for a total consideration of $174.8 million, increasing its stake to 100.0%. The allocation of purchase price increased the recorded cost of the customer base by $17.3 million, and $123.4 was recognized as goodwill. The customer base is amortised over the remaining term of contractual relationships of approximately three years. Goodwill is not deductible for income tax purposes and is attributable to the economic potential of the system integration market in CIS and synergies realized by the Group. In April 2009, a portion of distribution business of SITRONICS IT B.V. was disposed of.

Other acquisitions

Below are the other individually insignificant acquisitions for the year ended December 31, 2009:

| | For the year ended December 31, 2009 | | | | | |
|---|---|---|---|---|---|---|
| | | | Ownership interest | | | Purchase |
| **Acquiree** | **Principal activity** | **Date of acquisition** | **Before acquisition** | **After acquisition** | **Acquiring segment** | **price (in millions)** |
| Eldorado | Mobile retailer | March 2009 | 0% | 100% | Telecommunications | 17.8 |
| Telefon.ru | Mobile retailer | February 2009 | 0% | 100% | Telecommunications | 60.0 |
| Dagtelecom | Mobile operator | February 2009 | 75% | 100% | Telecommunications | 51.3 |
| Kolorit Dizayn Inc | Outdoor advertising services | September 2009 | 0% | 100% | Telecommunications | 39.7 |
| Teleforum | Mobile retailer | October 2009 | 0% | 100% | Telecommunications | 2.2 |
| **Total** | | | | | | **$ 171.0** |

As a result of the purchase price allocation related to other acquisitions, the Group assigned $2.5 million to the acquired brands, $4.7 million to the acquired customer base, $230.0 million to the goodwill and $30.3 to the fair value of contingent consideration.

## 4. DISPOSITIONS, CAPITAL TRANSACTIONS OF SUBSIDIARIES AND AFFILIATES AND DISCONTINUED OPERATIONS

Transactions within Oil and Energy segment

In order to create a vertically integrated oil group, the Group has undergone a number of intergroup restructuring initiatives. In January 2010, JSFC Sistema sold its stakes in Bashnefteproduct to Bashneft, a Group subsidiary. Upon completion of transaction, the Group's effective ownership in Bashnefteproduct has decreased resulting in an increase in noncontrolling interests and decrease in additional paid-in capital by $53.0 million. In December 2009, JSFC Sistema sold its stakes in Ufaneftekhim, Novoil, Ufaorgsintez and UNPZ to Bashneft, a Group subsidiary. Upon completion of these transactions, the Group's effective ownership in these subsidiaries has decreased resulting in an increase in noncontrolling interests by $671.0 million.

In October 2009, the Group reduced its equity stake in Bashneft from 77.8% to 72.9% in exchange for cash consideration of $122.3 million. The transaction was accounted for directly in equity and resulted in the increase in noncontrolling interests by $127.0 million.

Issuance of common shares of Detsky Mir

In December 2010, OJSC Detskiy Mir-Center, a subsidiary of the Group, increased its share capital through an additional share issue offered to Sberbank in a private placement. Detskiy Mir-Center issued 743 shares with a par value of RUB 100, representing 25%+1 share of the company's share capital after the additional issue. Sberbank acquired the stake in Detskiy Mir-Center for a total consideration of approximately RUB 3.4 billion (approximately $111.6 million as of December 31, 2010). The strategic objective of the shareholders is to attract a strategic investor or achieving a similar event. If such event for Detskiy Mir-Center is not achieved within three years, and under certain other conditions, Sberbank will have the right to sell its stake in Detskiy Mir-Center to Sistema. The parties also agreed to certain pre-emptive and tag-along and drag-along rights in relation to their respective stakes in Detskiy Mir-Center. As a 25%+1 shareholder of Detskiy Mir-Center, Sberbank is able to elect two out of eight board members. The transaction was accounted for directly in equity and resulted in the increase in noncontrolling interests by $12.7 million and corresponding increase in additional paid-in capital by $96.5 million.

Transactions within Telecommunications segment

In December 2010, MTS acquired 100% of Sistema Telecom LLC ("Sistema Telecom") from JSFC Sistema for RUB 11.6 billion ($379.0 million as of December 27, 2010). Sistema Telecom's key assets consist of property rights in respect of the group of trademarks, including the distinctive "egg" trademarks of MTS, Comstar-UTS and MGTS, certain promissory notes previously issued by MTS in the amount of RUB 2.0 billion ($65.5 million) and a 45% stake in TS-Retail, a 100% subsidiary of the Group. The acquisition was accounted for as a common control transaction directly in equity and resulted in the decrease in noncontrolling interests by $198.7 million.

In December 2009, through a series of transactions, a group of investment funds have exchanged their joint 14.2% stake in OJSC Moscow City Networks (MGTS) for 1.6% of the outstanding shares of MTS, previously held in treasury and $7.3 million in cash. Simultaneously, MTS received 11.06% of the total shares outstanding of Comstar UTS from MGTS Finance S.A., a wholly owned subsidiary of MGTS. As a result of the transactions, the Group's effective ownership in MTS decreased from 55.7% to 54.8% and its effective ownership in Comstar UTS increased from 33.1% to 35.1%. The transaction was accounted for directly in equity and resulted in an increase of noncontrolling interests by $135.1 million.

In October 2009, JSFC Sistema and Sistema Telecom, a Sistema subsidiary, sold their stakes in Comstar-UTS to MTS. As a result of above transactions, the Group's effective ownership in Comstar-UTS decreased. The transaction was accounted for directly in equity and resulted in the increase in noncontrolling interests by $154.6 million.

Issuance of common shares of SMM

In October 2009, SMM issued additional share capital which in exchange for noncontrolling interest in Russian World Studios (RWS), a SMM subsidiary. As a result of the transaction, SMM acquired a 100% stake in RWS and the Group share in SMM decreased from 100.0% to 75.0%. The transaction was accounted for directly in equity and resulted in the increase in noncontrolling interests by $38.0 million.

Disposal of Sistema-Hals

In a series of transactions in April – October 2009, the Group sold its controlling stake in Sistema-Hals for a total consideration of RUB 60.0. As a result of the transactions the Group's share in Sistema-Hals decreased from 80.0% to 28.2%. The transactions resulted in recognition of a loss on disposal of $364.9 million and the decrease in noncontrolling interests of $50.5.

In December 2010, the Group completed the sale of its 27.6% ownership share of Sistema-Hals to Blairwood Limited and Stoneflower Limited (each acquired the stake of 13.8%) for a total cash consideration of $70.0 million.

Disposal of investment in MTT

In March 2009, the Group sold 50.0% of the voting shares in MTT for a total consideration of $54.0 million. The transaction resulted in recognition of a loss of $19.4 million.

Discontinued operations of SITRONICS

In April 2009, SITRONICS disposed of distribution businesses of its wholly-owned subsidiary, SITRONICS IT B.V. Seven distribution companies were transferred to Melrose Holding (a Company owned by former management of SITRONICS IT B.V.) for a total consideration of $49.8 million.

The assets and liabilities of the discontinued operations of SITRONICS IT B.V. as at the date of disposal, April 14, 2009 and December 31, 2008, consisted of the following:

| | | April 14, 2009 | | December 31, 2008 |
|---|---|---|---|---|
| Current assets | $ | 121,066 | $ | 145,746 |
| Non-current assets | | 1,096 | | 1,492 |
| **Total assets of discontinued operations** | **$** | **122,162** | $ | **147,238** |
| Current liabilities | $ | 33,164 | $ | 56,990 |
| Non-current liabilities | | 13,000 | | 13,359 |
| **Total liabilities of discontinued operations** | **$** | **46,164** | $ | **70,349** |

As a result of the sale and subsequent settlement transactions, the Group reported a loss on disposal of discontinued operations of $26.2 million.

## 5. CASH AND CASH EQUIVALENTS

Included in the cash and cash equivalents balance are cash equivalents of $1,321.0 million and $1,952.4 million as of December 31, 2010 and 2009, respectively, which primarily comprise term deposits with banks and bank promissory notes with original maturities of less than 90 days.

## 6. ASSETS FROM BANKING ACTIVITIES, NET

Assets from banking activities, net of an allowance for loan losses, as of December 31, 2010 and 2009 consisted of the following:

| | | 2010 | | 2009 |
|---|---|---|---|---|
| Cash and cash equivalents | $ | 2,785,596 | $ | 2,163,852 |
| Loans to customers | | 3,447,603 | | 3,414,359 |
| Short-term investments in securities (trading) | | 694,753 | | 576,039 |
| Short-term investments in securities (available-for-sale) | | 434,098 | | 76,700 |
| Long-term investments in securities (held-to-maturity) | | - | | 323,195 |
| Other investments | | 197,351 | | 473,088 |
| Less: allowance for loan losses | | (257,052) | | (228,000) |
| Assets from banking activities, net | | 7,302,349 | | 6,799,233 |
| Less: amounts maturing after one year | | (1,812,743) | | (1,614,968) |
| **Assets from banking activities, current portion** | **$** | **5,489,606** | **$** | **5,184,265** |

Loans to customers as of December 31, 2010 and 2009 included loans to affiliates and other related parties of $nil and $65.5 million, respectively.

In May 2010 the Group sold the part of its bank bonds of the amount of $90.9 million, which were earlier classified as held to maturity. The remaining part of these bonds of the amount of $232.3 million was reclassified from held to maturity investments to available for sale and accounted for fair value.

The following table presents the effective average interest rates by categories of loans as of December 31, 2010 and 2009:

| | 2010 | | | 2009 | | |
|---|---|---|---|---|---|---|
| | **RUB** | **USD** | **Other currencies** | **RUB** | **USD** | **Other currencies** |
| Loans to customers | | | | | | |
| - corporate customers | 13.4% | 11.6% | 10.0% | 16.3% | 15.7% | 15.4% |
| - individuals | 16.5% | 10.4% | 12.6% | 16.6% | 13.4% | 14.5% |
| Loans to banks | 4.7% | 0.4% | 0.5% | 8.3% | 0.4% | 0.1% |

The movement in the allowance for loan losses for the years ended December 31, 2010 and 2009 was as follows:

| | **2010** | **2009** |
|---|---|---|
| Allowance for loan losses, beginning of the year | $ 228,000 | $ 193,394 |
| Additions charged to the results of operations | 38,797 | 87,433 |
| Write-off of allowance for loans losses | (9,126) | (51,182) |
| Currency translation adjustment | (619) | (1,645) |
| **Allowance for loan losses, end of the year** | **$ 257,052** | **$ 228,000** |

## 7. SHORT-TERM INVESTMENTS

Short-term investments as of December 31, 2010 and 2009 consisted of the following:

| | **2010** | **2009** |
|---|---|---|
| **Trading securities:** | | |
| Corporate bonds | - | $ 120,780 |
| Corporate shares | $ 2,827 | 2,283 |
| | 2,827 | 123,063 |
| **Other short-term investments:** | | |
| Promissory notes and deposit certificates from third parties | 47,076 | 259,250 |
| Promissory notes and loans to related parties | 28,825 | 24,942 |
| Bank deposits with original maturities exceeding 90 days | 773,540 | 130,016 |
| Funds in trust management | 26,986 | 20,077 |
| Other short-term investments | 426 | 18,618 |
| | 876,853 | 452,903 |
| **Total** | **$ 879,680** | **$ 575,966** |

Promissory notes from third parties, which are primarily denominated in RUB, bear interest rates varying from 5.5% to 14.0% as of December 31, 2010.

The effective interest rates on bank deposits with original maturities exceeding 90 days as of December 31, 2010 are between 2.0% to 9.0% for RUB and USD denominated deposits.
As of December 31, 2009, the effective interest rates on bank deposits with original maturities exceeding 90 days were between 6.5% to 9.0% for RUB and USD denominated deposits.

## 8. ACCOUNTS RECEIVABLE, NET

Accounts receivable, net of provision for doubtful accounts, as of December 31, 2010 and 2009 consisted of the following:

| | 2010 | 2009 |
|---|---|---|
| Trade receivables | $ 1,954,846 | $ 1,559,171 |
| Less: provision for doubtful accounts | (228,172) | (225,002) |
| **Total** | **$ 1,726,674** | **$ 1,334,169** |

Trade receivables as of December 31, 2010 and 2009 include receivables for services provided and goods shipped to the Group's affiliates and other related parties in the amounts of $1.0 million and $105.5 million, respectively. Management anticipates no losses in respect of receivables from related parties and accordingly no provision has been created in respect thereof.

## 9. INVENTORIES AND SPARE PARTS

Inventories and spare parts as of December 31, 2010 and 2009 consisted of the following:

| | 2010 | 2009 |
|---|---|---|
| Finished goods and goods for resale | $ 756,179 | $ 479,207 |
| Raw materials and spare parts | 539,000 | 483,322 |
| Work-in-progress | 212,863 | 183,911 |
| Costs and estimated earnings in excess of billings on uncompleted contracts | 6,686 | 8,646 |
| | 1,514,728 | 1,155,086 |
| Less: long-term portion | (13,716) | (17,792) |
| **Total** | **$ 1,501,012** | **$ 1,137,294** |

## 10. PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment, net of accumulated depreciation and depletion, as of December 31, 2010 and 2009 consisted of the following:

| | 2010 | 2009 |
|---|---|---|
| Switches, transmission devices, network and base station equipment | $ 11,295,627 | $ 10,069,994 |
| Refining, marketing, distribution and chemicals | 5,083,897 | 5,096,275 |
| Exploration and production assets | 3,899,433 | 3,515,365 |
| Other plant, machinery and equipment | 2,083,934 | 1,855,183 |
| Buildings and leasehold improvements | 1,782,206 | 1,823,421 |
| Power and utilities | 1,759,395 | 1,661,599 |
| Construction in-progress and equipment for installation | 872,518 | 956,202 |
| Telecommunication equipment for installation | 448,009 | 432,908 |
| Land | 33,650 | 33,208 |
| | 27,258,669 | 25,444,155 |
| Less: accumulated depreciation | (8,218,970) | (6,177,205) |
| **Total** | **$ 19,039,699** | **$ 19,266,950** |

Depreciation and depletion expenses for the year ended December 31, 2010 and 2009 amounted to $2,416.3 million and $2,017.3 million, respectively.

## 11. GOODWILL

The carrying amount of goodwill attributable to each reportable segment with goodwill balances and changes therein, are as follows:

| | Telecom-munications | Technology and Industry | Consumer assets | Total |
|---|---|---|---|---|
| **Balance as of January 1, 2009** | | | | |
| Gross amount of goodwill | $ 1,325,716 | $ 124,549 | $ 64,279 | $ 1,514,544 |
| Accumulated impairment loss | (49,891) | - | (63,560) | (113,451) |
| | **1,275,825** | **124,549** | **719** | **1,401,093** |
| Adjustments to preliminary allocations | 42,005 | - | - | 42,005 |
| Purchase price allocations | 328,565 | - | - | 328,565 |
| Currency translation adjustment | (74,653) | 190 | (207) | (74,670) |
| **Balance as of December 31, 2009** | | | | |
| Gross amount of goodwill | 1,620,208 | 124,739 | 64,072 | 1,809,019 |
| Accumulated impairment loss | (48,466) | - | (63,560) | (112,026) |
| | **$ 1,571,742** | **$ 124,739** | **$ 512** | **$ 1,696,993** |
| Adjustments to preliminary allocations | (6,004) | - | - | (6,004) |
| Purchase price allocations | 181,311 | - | - | 181,311 |
| Currency translation adjustment | 2,624 | (2,404) | - | 220 |
| **Balance as of December 31, 2010** | | | | |
| Gross amount of goodwill | 1,797,769 | 122,335 | 64,072 | 1,984,176 |
| Accumulated impairment loss | (48,096) | - | (63,560) | (111,656) |
| | **$ 1,749,673** | **$ 122,335** | **$ 512** | **$ 1,872,520** |

Amounts of goodwill in the Telecommunications segment are attributable to the following reporting units: MTS, SSTL and SMM. Goodwill in the Technology and Industry segment is attributable to SITRONICS.

Values assigned to key assumptions and estimates used to measure the unit's fair value are consistent with, as appropriate, external sources of information and historic data for each reporting unit. Management believes that the values assigned to the key assumptions and estimates represent the most realistic assessment of future trends.

No impairment was recognized based on the goodwill impairment tests as of December 31, 2010 and 2009. Fair value of the Group's reporting units was measured using a combination of present value techniques, the Gordon model and projected multiples.

## 12. OTHER INTANGIBLE ASSETS, NET

Intangible assets, other than goodwill as of December 31, 2010 and 2009 consisted of the following:

| | 2010 | | | 2009 | | |
|---|---|---|---|---|---|---|
| | Gross carrying value | Accumu-lated amortiza-tion | Net carrying value | Gross carrying value | Accumu-lated amortiza-tion | Net carrying value |
| **Amortized intangible assets:** | | | | | | |
| Acquired customer base | $ 649,231 | (236,326) | 412,905 | 596,583 | (251,352) | 345,231 |
| Radio frequencies | 314,722 | (100,496) | 214,226 | 239,045 | (75,351) | 163,694 |
| Operating licenses | 1,409,785 | (448,960) | 960,825 | 1,370,913 | (345,451) | 1,025,462 |
| Numbering capacity with finite contractual life, software and other | 2,343,980 | (1,194,063) | 1,149,917 | 2,105,459 | (1,089,064) | 1,016,395 |
| | 4,717,718 | (1,979,845) | 2,737,873 | 4,312,000 | (1,761,218) | 2,550,782 |
| **Unamortized intangible assets:** | | | | | | |
| Trademarks | 216,504 | - | 216,504 | 220,173 | - | 220,173 |
| Numbering capacity with indefinite contractual life | 68,596 | - | 68,596 | 27,047 | - | 27,047 |
| **Total intangible assets** | **$ 5,002,818** | **(1,979,845)** | **3,022,973** | **4,559,220** | **(1,761,218)** | **2,798,002** |

Amortization expense recorded on other intangible assets for the years ended December 31, 2010 and 2009 amounted to $530.0 million and $473.2 million, respectively. The estimated amortization expense for each of the five succeeding years and thereafter is as follows:

| Year ended December 31, | | |
|---|---|---|
| 2011 | $ | 848,740 |
| 2012 | | 547,574 |
| 2013 | | 383,302 |
| 2014 | | 246,408 |
| 2015 | | 164,272 |
| Thereafter | | 547,577 |
| | **$** | **2,737,873** |

Actual amortization expense to be reported in future periods could differ from these estimates as a result of new intangible assets acquisitions, changes in useful lives and other relevant factors.

## 13. INVESTMENTS IN AND LOANS TO AFFILIATES

Investments in affiliates as of December 31, 2010 and 2009 consisted of the following:

| | **2010** | | | **2009** | | |
|---|---|---|---|---|---|---|
| | **Voting power, %** | | **Carrying value** | **Voting power, %** | | **Carrying value** |
| MTS Belarus | 49.0% | **$** | 227,130 | 49.0% | **$** | 220,450 |
| SITRONICS NANO | 49.8% | | 243,366 | 49.8% | | 203,041 |
| Sky Link (Note 3) | disposed | | - | 50.0% | | 133,590 |
| RussNeft | 49.0% | | - | - | | - |
| Aspek | 49.9% | | 107,185 | - | | - |
| Belkamneft | 38.0% | | 559,784 | 38.0% | | 67,177 |
| Other investments at cost and loans to investees | Various | | 10,229 | Various | | 7,564 |
| **Total** | | **$** | **1,147,694** | | **$** | **631,822** |

***MTS Belarus*** – In April 2008 the Group entered into a credit facility agreement with MTS Belarus valid till March 15, 2009. The facility allowed MTS Belarus to borrow up to $33.0 million and bore interest at 10.0% per annum. In the year ended December 31, 2009 the maturity date was extended to March 15, 2010 and facility was increased to $46.0 million. In the year ended December 31, 2010 the maturity date was extended through March 15, 2011. The credit facility was fully paid upon maturity.

The financial position and results of operations of MTS Belarus as of and for the year ended December 31, 2010 and 2009 were as follows:

| | | **(unaudited)** | | |
|---|---|---|---|---|
| | | **2010** | | **2009** |
| Total assets | $ | 527,609 | $ | 498,278 |
| Total liabilities | | 72,533 | | 56,736 |
| Net income | | 145,707 | | 143,061 |

***SITRONICS-NANO LLC*** – In October 2009, SITRONICS entered into an agreement to form SITRONICS-Nano, which is owned 49.75% by SITRONICS, 49.75% by Russian Corporation of Nanotechnologies (“RUSNANO”) and 0.5% by another party. The primary purpose of SITRONICS-Nano is to acquire equipment and licenses necessary to launch 90 nanometer microchip production and to lease them to SITRONICS, and to provide project financing to SITRONICS. The equipment and licenses purchases will be financed through the equity of SITRONICS-Nano and external borrowings.

SITRONICS-Nano is determined to be a variable interest entity where SITRONICS has a variable interest through a lease agreement and is not the primary beneficiary. SITRONICS accounts for the investment under the equity method.

RUSNANO has a put option to sell its shares to Sistema at market price +25% not earlier than in nine years and not later than in 10.5 years from the date of financing (December 2009). Sistema has a call option to acquire at any time RUSNANO’s shares at RUB 6,480.0 million plus 18% p.a.

In addition, during the first nine years of operations of SITRONICS-Nano on non-fulfillment of certain criteria, RUSNANO can put its share in SITRONICS-Nano to Sistema at RUB 6,480.0 million ($213.3 million as of December 31, 2010) plus 18% p.a., less any net profit attributed and paid to RUSNANO during the period from the date of the put option application.

The maximum exposure to a loss is determined as the Group's contribution to SITRONICS-Nano adjusted by the Group's share of distributed results of the investee and is equal to $220.7 million.

The financial position and results of operations of SITRONICS-Nano as of and for the year ended December 31, 2010 and 2009 were as follows:

| | | (unaudited) | | |
|---|---|---|---|---|
| | | **2010** | | **2009** |
| Total assets | $ | 964,485 | $ | 440,283 |
| Total liabilities | | 488,692 | | 10,429 |
| Net loss/income | | (25,498) | | 1,075 |

***Oil Company RussNeft*** – In April 2010, the Group acquired a noncontrolling 49% stake in Oil Company RussNeft for a total cash consideration of $20 million.

The investment in noncontrolled entity is accounted for using the equity method. As a result of the final measurement of the equity stake in RussNeft, the Group recognized an impairement in the amount of $20 million in 2010.

The financial position and results of operations of RussNeft as of and for the year ended December 31, 2010 were as follows:

| | | (unaudited) 2010 |
|---|---|---|
| Total assets | $ | 6,219,259 |
| Total liabilities | | 7,206,314 |
| Net income | | 588,934 |

***Belkamneft*** – As of December 31, 2010 and 2009 the Group had a 38% investments in Belkamneft, held through its subsidiary, Bashneft. During the year-ended December 31, 2009, the Group was unable to exert any influence over the operations of Belkamneft, and so accounted for this investment using the cost method. RussNeft is the controlling shareholder of Belkamneft, and therefore following the acquisition of a 49% interest in RussNeft during 2010, the Group determined that it had attained significant influence over Bashneft's production subsidiary Belkamneft. The Group, as of the acquisition date of its additional indirect holding through RussNeft, remeasured, at fair value, its equity investment in Belkamneft and recognized a gain in the amount of $477.4 million. Retroactive application of the equity method of accounting for this investment was not performed due to immateriality.

The financial position and results of operations of Belkamneft as of and for the year ended December 31, 2010 were as follows:

| | | (unaudited) 2010 |
|---|---|---|
| Total assets | $ | 2,589,636 |
| Total liabilities | | 462,671 |
| Net income | | 127,586 |

***OJSC Aspek*** – In July 2010, Bashneft acquired 49.9% of OJSC Aspek ("Aspek") for cash consideration of RUB 3.7 billion (approximately $121.4 as of December 31, 2010). Aspek is a holding company with ownership in different businesses, including an oil and petrochemicals trading business and a petrol stations network. In accordance with the shareholders agreement, Aspek will be restructured in 2011 when certain assets will be distributed to the existing controlling shareholder. After completion of the restructuring, the Group's stake will increase to 100%.

As of December 31, 2010, the Group accounts for the 49.9% investment in accordance with the equity method. As a result of the final measurement of the equity stake in OJSC Aspek the Group recognized a loss in the amount of $16.8 million.

The financial position and results of operations of Aspek as of and for the year ended December 31, 2010 were as follows:

| | | **(unaudited)**<br>**2010** |
|---|---|---|
| Total assets | $ | 316,235 |
| Total liabilities | | 104,250 |
| Net income | | 10,537 |

## 14. INVESTMENT IN SHARES OF SVYAZINVEST

In December 2006, as a part of its program of regional expansion, Comstar UTS acquired a 25% stake plus one share in Telecommunication Investment Joint Stock Company ("Svyazinvest") from Mustcom Limited for a total consideration of approximately $1,390.0 million, including cash of $1,300.0 million and the fair value of the call and put option of $90.0 million. Comstar UTS and MGTS Finance S.A., a subsidiary of MGTS, have acquired 4,879,584,306 ordinary shares of Svyazinvest, with Comstar UTS buying 3,378,173,750 shares, which represent 17.3% of total outstanding shares of Svyazinvest, and MGTS Finance S.A. buying 1,501,410,556 shares, representing 7.7% of total outstanding shares of Svyazinvest. Svyazinvest is a holding company that holds controlling stakes in seven publicly traded incumbent fixed-line operators ("MRKs") based in all seven Federal districts of Russia, Rostelecom, a publicly traded long-distance fixed-line operator operating a Russia-wide network, and several other entities, the majority of which are non-public.

Based on the analysis of all relevant factors, the management determined that the acquisition of the 25% plus one share of Svyazinvest did not allow the Group to exercise significant influence over this entity due to its legal structure and certain limitations imposed by Svyazinvest's charter documents. Accordingly, the Group accounted for its investment in Svyazinvest under the cost method.

In November 2009, the Group and Svyazinvest ("the Parties") signed a non-binding memorandum of understanding ("MOU"), under which the Parties agreed to enter in a series of transactions which would ultimately result in (i) disposal of the Group's investment in Svyazinvest to a state-controlled enterprise; (ii) noncash extinguishment of the Group's indebtedness to Sberbank; (iii) increase in the Group's ownership in Sky Link to 100% and disposal of this investment to a state-controlled enterprise; and (iv) disposal of 28% of MGTS' common stock owned by Svyazinvest to the Group. In addition, certain cash consideration, the amount of which was under negotiations between the parties, was to be paid to Svyazinvest under the MOU (see Note 3).

Svyazinvest is a non-public entity and the Group had no access to consolidated financial information of Svyazinvest at a level of detail necessary to perform a complete fair value assessment of the Svyazinvest business directly, based on estimated future cash flows or otherwise. As a result, management had determined that the best estimate of the fair value of the Group's investment in Svyazinvest is the amount determined based on the MOU. Based on the MOU, the estimated fair value of the investment, which included significant unobservable inputs (Level 3 measurement), was approximately RUB 26.0 billion ($859.7 million as of December 31, 2009) compared to a carrying value of RUB 36.5 billion ($1,205.5 million as of December 31, 2009). As a result, during the year ended December 31, 2009 the Group had recorded an impairment loss of RUB 10.5 billion ($349.4 million).

In September 2010, the Group completed the sale of its Svyazinvest stake for a cash consideration of RUB 26.0 billion ($0.9 billion as of December 31, 2010) and repaid the outstanding debt to Sberbank in the amount of RUB 26.0 billion ($0.9 billion as of December 31, 2010) with proceeds from the sale.

## 15. LIABILITIES FROM BANKING ACTIVITIES

Liabilities from banking activities as of December 31, 2010 and 2009 consisted of the following:

| | | 2010 | | 2009 |
|---|---|---|---|---|
| Term deposits | $ | 3,026,225 | $ | 2,962,849 |
| Deposits repayable on demand | | 2,026,740 | | 1,472,648 |
| Promissory notes issued and other liabilities | | 583,654 | | 809,153 |
| | | 5,636,619 | | 5,244,650 |
| Less: amounts maturing after one year | | (1,444,783) | | (1,455,402) |
| **Total** | **$** | **4,191,836** | **$** | **3,789,248** |

Liabilities from banking activities as of December 31, 2010 and 2009 include liabilities with affiliates and other related parties for $153.8 million and $99.2 million, respectively.

The fair value of liabilities from banking activities approximates their carrying value.

The following table presents the effective average interest rates by categories of bank deposits and notes issued as of December 31, 2010 and 2009:

| | 2010 | | | 2009 | | |
|---|---|---|---|---|---|---|
| | RUB | USD | Other currencies | RUB | USD | Other currencies |
| Term deposits: | | | | | | |
| - corporate customers | 6.9% | 4.8% | 3.8% | 9.2% | 5.6% | 5.0% |
| - individuals | 11.0% | 7.8% | 7.5% | 12.8% | 9.3% | 8.6% |
| Promissory notes issued | 8.3% | 5.0% | - | 12.9% | 9.9% | 8.3% |
| Deposits repayable on demand: | | | | | | |
| - corporate customers | 1.6% | 0.0% | 0.0% | 0.3% | 0.3% | 0.1% |
| - individuals | 0.4% | 0.2% | 0.3% | 0.4% | 0.6% | 0.5% |

## 16. ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

Accrued expenses and other current liabilities as of December 31, 2010 and 2009 consisted of the following:

| | | 2010 | | 2009 |
|---|---|---|---|---|
| Customers' advances | $ | 775,973 | $ | 566,670 |
| Advance for shares of SSTL | | 602,276 | | - |
| Payroll and other accrued expenses | | 477,920 | | 402,550 |
| Accruals for services | | 365,447 | | 232,551 |
| Bitel liability (Note 25) | | 210,760 | | 170,000 |
| Accrued interest on loans | | 180,878 | | 254,251 |
| Tax and legal provisions | | 88,605 | | 125,660 |
| Financial instruments at fair value | | 57,473 | | 95,103 |
| Dividends payable | | 53,474 | | 9,037 |
| Other | | 528,841 | | 496,667 |
| **Total** | **$** | **3,341,647** | **$** | **2,352,489** |

In December 2010, Rosimushchestvo, the Russian Federal Agency for State Property Management, paid the rupee equivalent of $600 million for a stake of approximately 17% in SSTL's share capital, in which Sistema currently has an ownership percentage of 74%. At of December 31, 2010 SSTL was yet to issue shares to Rosimushchestvo relating to such contribution and consequently, the amount received was recognized in accrued expenses and other current liabilities as an advance for shares of SSTL.

In March 2011 SSTL has issued the shares to Rosimushchestvo. Following the additional share issue the total stake in the share capital of SSTL owned by Russian parties (Sistema and Rosimushchestvo) will not exceed 74%. SSTL plans to use the funds from the rights offering to finance the continued development of the company, and in particular to strengthen its leading position in wireless broadband (under EV-DO Rev. A). The funds will also be used to expand the branded retail network in its current telecommunication circles and to accelerate the launch of operations in a number of new circles.

## 17. SHORT-TERM LOANS PAYABLE

Short-term loans payable as of December 31, 2010 and 2009 consisted of the following:

| | Interest rate (Actual at December 31, 2010) | December 31, 2010 | December 31, 2009 |
|---|---|---|---|
| *USD-denominated:* | | | |
| VTB | 3.59% | $ 200,000 | $ - |
| Deutsche Bank AG | - | - | 20,408 |
| Other | Various | 14,890 | 47,940 |
| | | 214,890 | 68,348 |
| *RUB-denominated:* | | | |
| Sberbank | 7.2%-8.7% | 581,069 | 22,120 |
| B&N Bank | - | - | 51,249 |
| Uralsib | - | - | 50,367 |
| MDM Bank | - | - | 46,767 |
| Raiffeisenbank | - | - | 30,645 |
| Other | Various | 72,814 | 112,957 |
| | | 653,883 | 314,105 |
| Other currencies | Various | 208,732 | 81,729 |
| Loans from related parties | Various | 15,094 | 40,276 |
| **Total** | | **$ 1,092,599** | **$ 504,458** |

## 18. LONG-TERM DEBT

Long-term debt as of December 31, 2010 and 2009 consisted of the following:

| | December 31, 2010 | December 31, 2009 |
|---|---|---|
| Loans from banks and financial Institutions | $ 7,229,309 | $ 8,549,643 |
| Notes and corporate bonds | 6,674,890 | 5,970,658 |
| Capital leases | 250,876 | 181,047 |
| Loans from related parties | 50,339 | 118,013 |
| Other borrowings | 104,506 | 121,402 |
| | 14,309,920 | 14,940,763 |
| Less amounts maturing within one year | (2,103,405) | (3,736,708) |
| **Total** | **$ 12,206,515** | **$ 11,204,055** |

## Loans from banks and financial institutions

Loans from banks and financial institutions as of December 31, 2010 and 2009 consisted of the following:

| | Maturity | Interest rate (Actual at December 31, 2010) | December 31, 2010 | December 31, 2009 |
|---|---|---|---|---|
| *USD-denominated:* | | | | |
| Golden Gates (Bank of Moscow) | 2011-2013 | LIBOR+8.0% (8.3%), 9.8%-10.5% | $ 306,000 | $ 230,000 |
| Skandinaviska Enskilda Banken AB | 2011-2017 | LIBOR+0.23%-1.8% (0.68%-2.26%) | 242,013 | 279,519 |
| China Development Bank | 2011-2017 | LIBOR+1,5% (1.96%) | 157,406 | - |
| Bank of China | 2011-2017 | LIBOR+1,5%-1.95% (1.96%-2.41%) | 139,960 | - |
| EBRD | 2011-2014 | LIBOR+1.51%-3.1% (1.97%-3.56%) | 116,667 | 200,000 |
| HSBC Bank plc and ING BHF Bank AG | 2011-2014 | LIBOR+0.3% (0.76%) | 71,244 | 90,985 |
| Citibank International plc and ING Bank N.V. | 2011-2013 | LIBOR+0.43% (0.88%) | 62,486 | 84,560 |
| The Royal Bank of Scotland | 2011-2014 | LIBOR+0.35%-2.65% (0.81-2.95%) | 61,361 | 152,649 |
| HSBC Bank plc, ING Bank AG and Bayerische Landesbank | 2011-2015 | LIBOR+0.3% (0.76%) | 59,570 | 76,180 |
| Commerzbank AG, ING Bank AG and HSBC Bank plc | 2011-2014 | LIBOR+0.3% (0.76%) | 51,285 | 66,557 |
| Barclays Bank plc | 2011-2014 | LIBOR+0.13%-0.15% (0.59%-0.61%) | 46,047 | 59,203 |
| Troika Dialog Bank | 2011-2015 | LIBOR+6.5% (6.8%) | 30,000 | 30,000 |
| Societe Generale | 2011-2016 | LIBOR+1.25% (1.71%) | 20,768 | - |
| VTB | - | - | - | 755,173 |
| Sberbank | - | - | - | 370,000 |
| Syndicated Loan Facility granted to MTS in 2009 | - | - | - | 360,000 |
| Syndicated Loan Facility granted to MTS in 2006 | - | - | - | 323,077 |
| Other | 2011-2015 | Various | 14,128 | 89,029 |
| | | | 1,378,935 | 3,166,932 |
| *EUR-denominated:* | | | | |
| EBRD | 2011-2012 | EURIBOR+5.2% (6.21%) | 158,808 | 484,895 |
| Syndicated Loan to SITRONICS | 2011-2013 | EURIBOR+1.5% (2.73%) | 158,808 | 193,671 |
| BNP Paribas | 2011-2018 | EURIBOR+1.65% (2.88%) | 52,159 | - |
| LBWW | 2011-2017 | EURIBOR+0.75% (1.98%) | 43,201 | - |
| Bank of China | 2011-2016 | EURIBOR+1.95% (3.18%) | 35,123 | - |
| Syndicated Loan Facility granted to MTS in 2009 | - | - | - | 341,580 |
| Gazprombank | - | - | - | 286,920 |
| European Investment Bank | - | - | - | 164,979 |
| Nordic Investment Bank | - | - | - | 114,768 |
| Other | 2011-2014 | Various | 32,086 | 38,649 |
| | | | 480,185 | 1,625,462 |
| *RUB-denominated:* | | | | |
| Sberbank | 2011-2017 | 8.5%-14.50% | 2,053,182 | 2,878,897 |
| Gazprombank | 2013-2017 | 8.75%-11.85% | 990,914 | 213,600 |
| VTB | 2017 | 11.95% | 492,176 | - |
| VTB-Capital | 2017 | 11.95% | 492,176 | - |
| Bank of Moscow | 2013 | 8.0% – 9.5% | 459,364 | - |
| Unicredit | 2011-2016 | MosPrime+1.8%-5,2% (5.5%-8.9%) | 66,927 | 57,278 |
| Raiffeisenbank | 2011-2012 | MosPrime+5.2%-5.4% (8.9%-9.5%) | 63,172 | 39,677 |
| Other | Various | Various | 15,118 | 49,619 |
| | | | 4,633,029 | 3,239,071 |
| *Other currencies-denominated* | | | | |
| State Bank of India | 2012 | 11% | 535,595 | - |
| Other | 2011-2018 | Various | 201,565 | 518,178 |
| | | | 737,160 | 518,178 |
| **Total** | | | **$ 7,229,309** | **$ 8,549,643** |

Certain loans from banks and financial institutions are subject to restrictive covenants, including, but not limited to, compliance with certain financial ratios, limitations on dispositions of assets and limitations on transactions within the Group. Management believes that the Group is in compliance with all restrictive provisions of loans from banks and financial institutions as of December 31, 2010.

Equipment with carrying value of $280.3 million is pledged to collateralize some of the other loan facilities provided to the Group as of December 31, 2010.

### Notes and corporate bonds

Notes and corporate bonds as of December 31, 2010 and 2009 consisted of the following:

| | Currency | Interest rate | December 31, 2010 | December 31, 2009 |
|---|---|---|---|---|
| Bashneft Bonds due 2016 | RUB | 12.5% | $ 1,640,587 | $ 1,653,209 |
| MTS International Notes due 2020 | USD | 8.6% | 750,000 | - |
| JSFC Sistema Bonds due 2014 | RUB | 14.8% | 648,155 | 661,284 |
| JSFC Sistema Bonds due 2016 | RUB | 12.5% | 623,423 | 628,220 |
| MTS Notes due 2014 | RUB | 16.8% | 492,176 | 495,963 |
| MTS Notes due 2016 | RUB | 14.3% | 492,176 | 495,963 |
| MTS Notes due 2020 | RUB | 8.2% | 492,176 | - |
| MTS Finance Notes due 2012 | USD | 8.0% | 400,000 | 400,000 |
| MTS Notes due 2017 | RUB | 8.7% | 328,117 | - |
| MTS Notes due 2018 | RUB | 8.0% | 315,337 | 298,155 |
| JSFC Sistema Bonds due 2013 | RUB | 9.8% | 196,870 | 184,236 |
| SITRONICS Bonds due 2013 | RUB | 10.8% | 98,435 | - |
| Intourist Bonds due 2013 | RUB | 14.0% | 65,623 | - |
| SITRONICS Bonds due 2013 | RUB | 11.8% | 41,212 | - |
| MTS Notes due 2015 | RUB | 7.8% | 39,823 | 248,213 |
| DM-Center Bonds due 2015 | RUB | 8.5% | 37,733 | 38,024 |
| MTS Notes due 2013 | RUB | 7.0% | 13,250 | 247,981 |
| MTS Finance Notes due 2010 | USD | 8.4% | - | 400,000 |
| SITRONICS Bonds due 2010 | RUB | 22.0% | - | 96,841 |
| Sistema Capital Notes due 2011 | USD | 8.9% | - | 89,480 |
| Intourist Bonds due 2010 | RUB | 9.0% | - | 33,064 |
| MGTS Bonds due 2010 | RUB | 16.0% | - | 402 |
| | | | 6,675,093 | 5,971,035 |
| Less: unamortized discount | | | (203) | (377) |
| **Total notes and corporate bonds** | | | **$ 6,674,890** | **$ 5,970,658** |

In certain instances the Group has an unconditional obligation to repurchase notes at par value if claimed by the noteholders, where a subsequent sequential coupon is announced.

The notes therefore can be defined as callable obligations under the FASB authoritative guidance on debt, as the holders have the unilateral right to demand repurchase of the notes at par value upon announcement of new coupons. The FASB authoritative guidance on debt requires callable obligations to be disclosed as maturing in the reporting period, when the demand for repurchase could be submitted disregarding the expectations of the Group about the intentions of the noteholders. The Group discloses such notes in the aggregated maturities schedule as these are the reporting periods when the noteholders will have the unilateral right to demand repurchase.

The fair values of notes and corporate bonds based on the market quotes as of December 31, 2010 at the stock exchanges where they are traded were as follows:

| | Stock exchange | % of par | Fair value |
|---|---|---|---|
| Bashneft Bonds due 2016 | MICEX stock exchange | 108.15 | $ 1,774,295 |
| MTS International Notes due 2020 | Irish stock exchange | 112.40 | 843,000 |
| JSFC Sistema Bonds due 2014 | MICEX stock exchange | 111.25 | 721,072 |
| JSFC Sistema Bonds due 2016 | MICEX stock exchange | 108.67 | 677,474 |
| MTS Notes due 2014 | MICEX stock exchange | 104.03 | 512,011 |
| MTS Notes due 2016 | MICEX stock exchange | 99.85 | 491,438 |
| MTS Notes due 2020 | MICEX stock exchange | 98.00 | 482,333 |
| MTS Finance Notes due 2012 | Luxembourg stock exchange | 105.61 | 422,440 |
| MTS Notes due 2017 | MICEX stock exchange | 99.65 | 326,696 |
| MTS Notes due 2018 | MICEX stock exchange | 101.50 | 320,067 |
| JSFC Sistema Bonds due 2013 | MICEX stock exchange | 104.40 | 205,532 |
| Intourist Bonds due 2013 | MICEX stock exchange | 102.70 | 67,395 |
| SITRONICS Bonds due 2013 | MICEX stock exchange | 100.00 | 98,435 |
| SITRONICS Bonds due 2013 | MICEX stock exchange | 102.25 | 42,139 |
| MTS Notes due 2015 | MICEX stock exchange | 100.50 | 40,042 |
| DM-Center Bonds due 2015 | MICEX stock exchange | 94.00 | 35,469 |
| MTS Notes due 2013 | MICEX stock exchange | 99.96 | 13,244 |
| | | | **$ 7,073,082** |

Notes and corporate bonds are subject to certain financial and non-financial restrictive covenants, including, but not limited to, limitations on dispositions of assets, limitations on transactions with affiliates, compliance with certain financial ratios.

On November 11, 2010 an international arbitration tribunal constituted under the rules of the London Court of International Arbitration rendered an award with regards to arbitration commenced by Nomihold Securities Inc. in April 2007. The ruling requires the Group's subsidiary, MTS Finance, to honor Nomihold's option to sell MTS Finance the remaining 49% stake in Tarino Limited for $170 million, plus interest, plus $5.88 million in dividends and to compensate it for related costs. MTS Finance appealed against the award, however the appeal was rejected and the award became final on January 5, 2011. In connection with the above mentioned restriction concerning the unsatisfied liability arising from any judgment against the Group, prior to the date these consolidated financial statements were issued, the Group obtained consents from the noteholders of MTS Finance Notes due 2012 and MTS International Notes due 2020 and banks, with the exception of Barclays Bank, to (1) waive certain defaults and events of default which might arise under the loan agreements as a result of the award, and (2) certain amendments to the loan agreements to avoid possible future events of default which may arise as a result of the award. Therefore, the Group classified the notes and bank loans in accordance with their original maturities in its consolidated statement of financial position as of December 31, 2010, with the exception of the credit facility with Barclays Bank classified as current and fully repaid in February 2011.

Other than as mentioned above, management believes that the Group is in compliance with all restrictive provisions of notes and corporate bonds as of December 31, 2010.

The schedule of repayments of long-term debt over the five-year period and thereafter beginning on December 31, 2010 is as follows:

| Year ended December 31, | | |
|---|---|---|
| 2011 | $ | 2,103,405 |
| 2012 | | 4,334,565 |
| 2013 | | 1,557,911 |
| 2014 | | 541,953 |
| 2015 | | 1,478,907 |
| Thereafter | | 4,293,179 |
| **Total** | **$** | **14,309,920** |

## 19. INCOME TAX

The Group's provision for income taxes for the year ended December 31, 2010 and 2009 was:

| | | 2010 | | 2009 |
|---|---|---|---|---|
| Current provision | $ | 1,116,895 | $ | 776,622 |
| Deferred income tax benefit | | (27,932) | | (29,954) |
| **Total income tax expense** | **$** | **1,088,963** | **$** | **746,668** |

The provision for income taxes is different from that which would be obtained by applying the statutory income tax rate to income from continuing operations before income tax. The items causing this difference are as follows:

| | | 2010 | | 2009 |
|---|---|---|---|---|
| Income tax provision computed on income before taxes at statutory rate of 20% in 2010 and 2009 | $ | 584,155 | $ | 610,910 |
| Adjustments due to: | | | | |
| Change in valuation allowance | | 105,129 | | 191,253 |
| Non-deductible expenses | | 251,648 | | 149,946 |
| Earnings distribution from subsidiaries | | 80,530 | | 101,642 |
| Effect of Group restructuring | | 75,400 | | 232,900 |
| Impairment of long-lived assets in Turkmenistan | | 27,565 | | - |
| Additions/(reductions) to unrecognized tax benefits | | 766 | | (10,451) |
| Dispositions of subsidiaries | | - | | 68,209 |
| Non-taxable gain on bargain purchase | | - | | (556,567) |
| Currency exchange and translation differences | | (2,391) | | 2,871 |
| Effect of rates different from standard | | (6,587) | | (698) |
| Settlements with tax authorities on prior period income tax | | (27,252) | | (43,347) |
| **Income tax expense** | **$** | **1,088,963** | **$** | **746,668** |

The tax effects of temporary differences that give rise to the deferred tax assets and liabilities are presented below:

| | 2010 | 2009 |
|---|---|---|
| **Deferred tax assets** | | |
| Tax losses carried forward | $ 475,523 | $ 266,421 |
| Property, plant and equipment | 404,713 | 303,238 |
| Accrued expenses | 172,593 | 178,605 |
| Inventory obsolescence | 61,762 | 24,305 |
| Allowance for doubtful accounts and loans receivable | 38,904 | 18,229 |
| Intangible assets | 37,517 | 46,637 |
| Deferred connection fees | 31,522 | 16,663 |
| Deferred revenues | 20,832 | 33,610 |
| Valuation of investment in Svyazinvest | - | 78,761 |
| Other | 77,570 | 109,749 |
| | 1,320,936 | 1,076,218 |
| Less: valuation allowance | (460,660) | (316,744) |
| **Total deferred tax assets** | **$ 860,276** | **$ 759,474** |
| **Deferred tax liabilities** | | |
| Property, plant and equipment | (1,418,898) | (1,375,148) |
| Intangible assets | (257,604) | (247,571) |
| Undistributed earnings of subsidiaries and affiliates | (242,367) | (161,294) |
| Debt issuance costs | (34,966) | (32,505) |
| Other | (36,990) | (48,562) |
| **Total deferred tax liabilities** | **$ (1,990,825)** | **$ (1,865,080)** |
| Net deferred tax assets, current | $ 357,821 | $ 348,965 |
| Net deferred tax assets, long-term | $ 317,195 | $ 243,569 |
| Net deferred tax liabilities, current | $ (168,982) | $ (87,415) |
| Net deferred tax liabilities, long-term | $ (1,636,583) | $ (1,610,725) |

The Group has the following significant balances for income tax losses carried forward as of December 31, 2010 and 2009:

| Jurisdiction | Period for carry-forward | 2010 | 2009 |
|---|---|---|---|
| India | 2011-2018 | $ 241,330 | $ 105,462 |
| Luxembourg | Unlimited | 124,464 | 94,163 |
| Russia | 2011-2020 | 94,164 | 37,934 |
| Other | 2011-2013 | 15,565 | 28,862 |
| **Total** | | **$ 475,523** | **$ 266,421** |

Management established the following valuation allowances against deferred tax assets because there will not be sufficient future taxable income against which to realize such assets:

| Valuation allowances | 2010 | 2009 |
|---|---|---|
| Tax losses carried forward | $ 335,362 | $ 199,625 |
| Sale of investment in Svyazinvest | 66,887 | 78,800 |
| Other | 58,411 | 38,319 |
| **Total** | **$ 460,660** | **$ 316,744** |

As of December 31, 2010 and 2009 the Group included accruals for uncertain tax positions in the amount of $14.5 million and $11.2 million, respectively, as a component of income tax payable.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

| | 2010 | 2009 |
|---|---|---|
| Balance, beginning of the year | $ 11,179 | $ 19,798 |
| Additions based on tax positions related to the current year | 14,590 | 2,094 |
| Additions based on tax positions related to the prior year | 1,504 | - |
| Additions based on tax of acquired entities | 7,587 | 1,521 |
| Reduction on tax positions of disposed entities | (2,141) | (4,045) |
| Reduction in tax positions related to prior years | (47) | (1,778) |
| Reductions in tax positions due to change of tax position during the year | - | (2,848) |
| Settlements with tax authorities | (18,109) | (3,305) |
| Currency translation adjustment | (56) | (258) |
| **Balance, end of the year** | **$ 14,507** | **$ 11,179** |

Accrued penalties and interest related to unrecognized tax benefits as a component of income tax expense for the years ended December 31, 2010 and 2009 amounted to charge of $3.3 million and reversal of ($0.6) million respectively, and are included in income tax expense in the accompanying consolidated statements of operations. Accrued interest and penalties were included in income tax payable in the accompanying consolidated statements of financial position and totaled to $3.3 million and $4.3 million as of December 31, 2010 and 2009, respectively. The Group does not expect the unrecognized tax benefits to change significantly over the next twelve months.

## 20. FAIR VALUE MEASUREMENTS AND DERIVATIVE FINANCIAL INSTRUMENTS

The following fair value hierarchy table presents information regarding Group's assets and liabilities measured at fair value on a recurring basis as of December 31, 2010 and 2009:

| | Level 1 (quoted prices in active markets for identical assets or liabilities) | Level 2 (significant other observable inputs) | Level 3 (significant unobservable inputs) | Total fair value |
|---|---|---|---|---|
| *December 31, 2010* | | | | |
| **Assets at fair value:** | | | | |
| Trading securities | $ 694,753 | - | - | $ 694,753 |
| Available for sale securities | 224,732 | $ 209,366 | - | 434,098 |
| MTS interest rate swaps | - | 3,322 | - | 3,322 |
| MTS currency option agreements | - | 247 | - | 247 |
| **Total assets** | **$ 919,485** | **$ 212,935** | **-** | **$ 1,132,420** |
| **Liabilities at fair value:** | | | | |
| MTS interest rate swaps | - | (31,315) | - | (31,315) |
| MTS buy-out put option | - | (11,636) | - | (11,636) |
| MTS cross-currency interest rate swaps | - | (3,469) | - | (3,469) |
| MTS currency option agreements | - | (2,612) | - | (2,612) |
| RUSNANO put option (Note 13) | - | - | (22,689) | (22,689) |
| Redeemable noncontrolling interests (Note 2) | - | - | (107,343) | (107,343) |
| **Total liabilities** | **$ -** | **$ (49,032)** | **$ (130,032)** | **$ (179,064)** |
| *December 31, 2009* | | | | |
| **Assets at fair value:** | | | | |
| Trading securities | 698,318 | - | - | 698,318 |
| Available for sale securities | 57,885 | - | - | 57,885 |
| MTS interest rate swaps | - | 3,391 | - | 3,391 |
| **Total assets** | **$ 756,203** | **$ 3,391** | **$ -** | **$ 759,594** |
| **Liabilities at fair value:** | | | | |
| MTS interest rate swaps | - | (32,636) | - | (32,636) |
| MTS cross-currency interest rate swaps | - | (26,559) | - | (26,559) |
| MTS currency option agreements | - | (4,280) | - | (4,280) |
| JSFC Sistema foreign currency forward agreement | - | (11,000) | - | (11,000) |
| RUSNANO put option (Note 13) | - | - | (20,627) | (20,627) |
| Redeemable noncontrolling interests (Note 2) | - | - | (82,261) | (82,261) |
| **Total liabilities** | **$ -** | **$ (74,475)** | **$ (102,888)** | **$ (177,363)** |

The Group uses derivative instruments as part of its overall strategy to manage its exposure to market risks primarily associated with fluctuations in foreign currency and interest rates. The Group does not use derivatives for trading or speculative purposes.

**Interest Rate Risk**

A portion of the debt held by the Group is exposed to interest rate fluctuations. The Group uses various hedging strategies and derivative financial instruments to create an appropriate mix of fixed and floating rate debt. The primary interest rate exposure was related to interest rate fluctuations in EURIBOR and LIBOR. The Group currently uses interest rate and cross-currency swaps as the derivative instruments in these hedging strategies. Several derivatives used to manage the risk associated with the Group's floating rate debt are designated as cash flow hedges.

**Foreign Currency Risk**

A portion of the debt held by the Group is denominated in USD, and since most of the operations are in Russian Rubles, there is exposure to foreign currency rate fluctuations between the Ruble and the USD. The Group, from time-to-time, enters into foreign currency option agreements that allow the company to have a combination of put and call option rights to acquire foreign currencies at different rates to manage the exposure to exchange rate fluctuations between the USD and the Ruble.

A description of the Group's hedging activities is as follows:

***Cash flow hedging***

In 2009 the Group entered into several cross-currency interest rate swap and variable-to-fixed interest rate swap agreements to manage the exposure of changes in variable interest rate and exchange rates related to its debt obligations. The instruments qualified for cash flow hedge accounting under the US GAAP. Each interest rate swap matched the exact maturity dates of the underlying debt allowing for highly-effective hedges.

These contracts hedge the risk of both interest rate and currency fluctuations and assume periodical exchanges of both principal and interest payments from RUB-denominated amounts to USD- and Euro-denominated amounts to be exchanged at a specified rate. The rate was determined by the market spot rate upon issuance. These contracts also include an interest rate swap of a fixed USD- and Euro-denominated interest rate to a fixed RUB-denominated interest rate. The instruments are qualified for cash flow hedge accounting under the U.S. GAAP requirements. Each cross-currency interest swap matched the interest and principal payments of the underlying debt allowing for highly-effective hedges. Cross-currency interest rate swap contracts outstanding as of December 31, 2010 mature in 2011.

The following table presents the fair value of Group's derivative instruments designated as hedges in the consolidated statements of financial position as of December 31, 2010 and 2009.

| | Statement of financial position location | December 31, 2010 | December 31, 2009 |
|---|---|---|---|
| ***Asset derivatives*** | | | |
| Interest rate swaps | Other non-current assets | $ 3,322 | 3,391 |
| **Total** | | **$ 3,322** | **3,391** |
| ***Liability derivatives*** | | | |
| Interest rate swaps | Accrued expenses and other current liabilities | $ (31,315) | $ (32,636) |
| Cross-currency interest rate swaps | Other payables | (3,469) | (9,211) |
| Cross-currency interest rate swaps | Accrued expenses and other current liabilities | - | (17,348) |
| **Total** | | **$ (34,784)** | **$ (59,195)** |

The following table presents the effect of Group's derivative instruments designated as hedges on the consolidated statements of operations for the years ended December 31, 2010 and 2009.

| | Location of loss recognized | Year ended December 31, 2010 | Year ended December 31, 2009 |
|---|---|---|---|
| Interest rate swaps | Interest expense | $ (32,726) | $ (8,392) |
| Cross-currency interest rate swaps | Currency exchange and transaction loss | (37,820) | (24,299) |
| **Total** | | **$ (70,546)** | **$ (32,691)** |

The following table presents the effect of Group's derivative instruments designated as hedges on accumulated other comprehensive income for the years ended December 31, 2010 and 2009.

| | | 2010 | | 2009 |
|---|---|---|---|---|
| Accumulated derivatives (loss)/gain, beginning of the year | $ | (40,293) | $ | (16,714) |
| Fair value adjustments on hedging derivatives, net of tax | | (39,757) | | (28,764) |
| Amounts reclassified into earnings during the period, net of tax | | 65,185 | | 5,185 |
| Accumulated derivatives loss, end of the year | $ | (14,865) | $ | (40,293) |

As of December 31, 2010, the outstanding hedge instruments were highly effective. Approximately $7.0 million of net loss is expected to be reclassified into net income during the next twelve months.

Cash inflows and outflows related to hedge instruments were included in the cash flows from operating activities in the consolidated statement of cash flows for the years ended December 31, 2010 and 2009.

***Non-designated derivative instruments***

***MTS foreign currency options*** – In 2010 and 2009 the Group entered into foreign currency option agreements to manage the exposure to changes in currency exchange rates related to USD-denominated debt obligations. The agreements include a combination of put and call option rights to acquire $330.0 million of USD at rates within a range specified in contracts. These contracts were not designated for hedge accounting purposes. These currency option agreements will mature in 2011-2012.

***MTS buy-out put option*** – On December 23, 2010, simultaneously with the meeting of MTS' shareholders, the meeting of Comstar-UTS' shareholders approved the reorganization of Comstar-UTS through the statutory merger into OJSC MTS. In accordance with the Russian legislation, shareholders who voted against or did not vote on the merger have the right to sell their shares back to Comstar-UTS for cash at a price set by the company's Boards of Directors, subject to the statutory limit of 10% of the company's net asset value under the Russian Accounting Standards. Eligible shareholders shall file a buyout demand within no later than 45 (forty five) days after the adoption of the resolution on reorganization. The buy-out of shares shall be carried out within 30 days after the expiry of the period set for the buyout demand being made. Fair value of the Group's liability under the put option as of December 31, 2010 was estimated at $11.6 million using an option pricing model.

***Comstar UTS purchased call option*** – In the third quarter of 2008 in order to mitigate the exposure resulting from the employee phantom option program introduced in April 2008, Comstar-UTS acquired a phantom call option on its GDRs for $19.4 million from an investment bank. The amount of cash paid was included in the cash flows from investing activities in the consolidated statement of cash flows for the year ended December 31, 2008. The agreement entitles Comstar-UTS to receive in the second quarter of 2010 a payment equal to the difference between the average of daily volume-weighted average trading prices of GDRs on the London Stock Exchange for the period between February 1 and March 31, 2010 and the phantom option exercise price of $10.2368, if positive, multiplied by 9,000,000. Subsequent to the acquisition of the instrument, the Group estimates the fair value of the respective asset using an option pricing model and re-measures it as of each reporting date. In April 2010 the purchased call option expired unexercised as it was out-of-money.

***JSFC Sistema foreign currency forward agreement*** – In 2009 JSFC Sistema entered into foreign currency forward agreements to manage exposure to changes in currency exchange rates. As of December 31, 2010, Sistema has executed its foreign currency forward contracts and recorded a loss of $5.3 million in the Group's consolidated statement of operations.

The following table presents the fair value of Group's derivative instruments not designated as hedges in the consolidated statements of financial position as of December 31, 2010 and 2009.

| | Statement of financial position location | December 31, 2010 | December 31, 2009 |
|---|---|---|---|
| ***Asset derivatives:*** | | | |
| MTS foreign currency options | Other non-current assets | $ 247 | $ - |
| **Total** | | **$ 247** | **$ -** |
| ***Liability derivatives:*** | | | |
| MTS foreign currency options | Accrued expenses and other current liabilities | $ (92) | $ (2,654) |
| MTS buy-out put option | Accrued expenses and other current liabilities | (11,636) | - |
| MTS foreign currency options | Accrued expenses and other current liabilities | (2,520) | (1,627) |
| JSFC Sistema foreign currency forward agreement | Accrued expenses and other current liabilities | - | (11,000) |
| RUSNANO put option (Note 13) | Accrued expenses and other current liabilities | (22,689) | (20,627) |
| **Total** | | **$ (36,937)** | **$ (35,908)** |

The following table presents the effect of Group's derivative instruments not designated as hedges on the consolidated statements of operations for the years ended December 31, 2010 and 2009.

| | Location of gain/(loss) recognized | Year ended December 31, 2010 | Year ended December 31, 2009 |
|---|---|---|---|
| RUSNANO put option (Note 13) | Change in fair value of derivative instruments | $ (2,062) | - |
| MTS currency forward | Currency exchange and transaction gain | - | $ 12,788 |
| MTS foreign currency options | Currency exchange and transaction gain/(loss) | 1,916 | (4,280) |
| JSFC Sistema foreign currency forward agreement | Currency exchange and transaction loss | (5,334) | (15,005) |
| Comstar UTS purchased call option | Change in fair value of derivative instruments | - | (5,420) |
| **Total** | | **$ (5,480)** | **$ (11,917)** |

## 21. SHARE CAPITAL

As of December 31, 2010 and 2009, JSFC Sistema had 9,650,000,000 voting common shares issued and 9,281,827,594 shares outstanding with a par value of RUB 0.09.

In June 2010, JSFC Sistema declared dividends the year ended December 31, 2009 amounting to RUB 530.8 million (equivalent of $17.5 million as of December 31, 2010). No dividends were declared in 2009.

## 22. SEGMENT INFORMATION

In accordance with U.S. GAAP, operating segments are defined as components of an enterprise engaging in business activities for which separate financial information is available that is evaluated regularly by the chief operating decision maker or group in deciding how to allocate resources and in assessing performance.

As the management of the Group reviews the business operations based on the product and service lines, the four Group's operating segments are organized as follows: Telecommunications, Technology and Industry, Consumer Assets, and Oil and Energy. Corporate and Other comprise the companies that control and manage the Group's interests in its subsidiaries. Refer to accounting policies in Note 2 for further discussion of the types of products and services and method of revenue generation and related accounting treatment included within each operating segment. The Group's management evaluates the performance of the segments based on segment operating income. Intercompany eliminations presented below consist primarily of the following items: intercompany sales transactions, elimination of gross margin in inventory and other intercompany transactions conducted under the normal course of operations.

An analysis and reconciliation of the Group's business segment information to the respective information in the consolidated financial statements for the years ended December 31, 2010 and 2009 is shown below. Any differences between the business segment information provided and the corresponding information in the consolidated financial statements which have not been reconciled below relate to intercompany eliminations:

| **For the year ended December 31, 2010** | **Telecom-munications** | **Technology and Industry** | **Consumer Assets** | **Oil and Energy** | **Corporate and Other** | **Total** |
|---|---|---|---|---|---|---|
| Net sales to external customers [(a)] | 11,476,224 | 1,317,291 | 1,949,670 | 13,316,711 | 38,577 | 28,098,473 |
| Intersegment sales | - | 464,339 | 28,994 | 1,331 | 24,736 | 519,400 |
| Equity in results of affiliates | 54,544 | 1,389 | 228 | 36,074 | 17,883 | 110,118 |
| Interest income | 89,757 | 7,614 | 3,511 | 44,104 | 90,494 | 235,480 |
| Interest expense | 883,042 | 90,696 | 52,457 | 353,110 | 329,106 | 1,708,411 |
| Net interest revenue [(b)] | - | - | 24,443 | - | - | 24,443 |
| Depreciation, depletion and amortization | 2,062,456 | 106,181 | 61,166 | 709,033 | 7,546 | 2,946,382 |
| Segment operating income | 2,282,378 | 37,638 | 144,577 | 2,295,295 | (288,791) | 4,471,097 |
| Income tax expense/(benefit) | 563,067 | 28,133 | 15,554 | 483,495 | (1,286) | 1,088,963 |
| Investments in affiliates | 236,532 | 220,755 | 5,132 | 666,969 | 29,967 | 1,159,355 |
| Segment assets | 17,886,600 | 3,003,917 | 9,028,243 | 14,588,850 | 3,466,480 | 47,974,090 |
| Indebtedness [(c)] | 8,422,811 | 935,586 | 362,001 | 3,932,594 | 1,749,527 | 15,402,519 |
| Capital expenditures | 2,870,697 | 96,055 | 65,096 | 1,088,772 | 58,954 | 4,179,574 |

| **For the year ended December 31, 2009** | **Telecom-munications** | **Technology and Industry** | **Consumer Assets** | **Oil and Energy** | **Corporate and Other** | **Total** |
|---|---|---|---|---|---|---|
| Net sales to external customers [(a)] | 9,948,871 | 1,186,046 | 1,866,814 | 5,729,349 | 18,736 | 18,749,816 |
| Intersegment sales | 7,085 | 322,410 | 29,965 | 1,298 | 14,131 | 374,889 |
| Equity in results of affiliates | 20,413 | - | (33,171) | - | 4,400 | (8,358) |
| Interest income | 113,145 | 17,876 | 7,116 | 33,350 | 142,500 | 313,987 |
| Interest expense | 632,603 | 78,022 | 68,791 | 218,745 | 343,170 | 1,341,331 |
| Net interest revenue [(b)] | - | - | 51,887 | - | - | 51,887 |
| Depreciation, depletion and amortization | 1,864,168 | 68,027 | 52,414 | 498,191 | 7,714 | 2,490,514 |
| Segment operating income | 2,016,267 | (6,408) | (236,193) | 3,370,611 | 670,911 | 5,815,188 |
| Income tax expense/(benefit) | 551,403 | (4,943) | 5,310 | 114,667 | 80,231 | 746,668 |
| Investments in affiliates | 355,749 | 182,414 | - | 69,832 | 26,660 | 634,655 |
| Segment assets | 18,794,885 | 2,806,649 | 10,205,498 | 12,808,809 | 3,648,072 | 48,263,913 |
| Indebtedness [(c)] | 8,910,702 | 926,239 | 403,040 | 2,500,349 | 2,704,891 | 15,445,221 |
| Capital expenditures | 2,617,655 | 333,523 | 78,220 | 403,529 | 1,489 | 3,434,416 |

(a)-Interest income and expenses of the banking division are presented as revenues from financial services and cost of financial services, correspondingly, in the Group's consolidated financial statements.

(b)-The banking division derives a majority of its revenue from interest. In addition, management primarily relies on net interest revenue, not the gross revenue and expense amounts, in managing that division. Therefore, only the net amount is disclosed.

(c)-Represents the sum of short-term and long-term debt

The reconciliation of the segment measure of profit segment operating income to the consolidated income from continuing operations before income tax, equity in net income of energy companies in the Republic of Bashkortostan and noncontrolling interests and reconciliation of assets to the consolidated segment assets are as follows:

| | 2010 | 2009 |
|---|---|---|
| Total segment operating income | $ 4,471,097 | $ 5,815,188 |
| Intersegment eliminations | (108,906) | (1,578,430) |
| **Operating income** | **4,362,191** | **4,236,758** |
| Interest income | 131,428 | 192,176 |
| Change in fair value of derivative financial instruments | (2,062) | (35,200) |
| Interest expense | (1,597,238) | (1,246,361) |
| Currency exchange and translation gain/(loss) | 26,456 | (92,825) |
| **Consolidated income from continuing operations before income tax** | **$ 2,920,775** | **$ 3,054,548** |

| | 2010 | 2009 |
|---|---|---|
| Total segment assets | $ 47,974,090 | $ 48,263,913 |
| Intersegment eliminations | (3,864,979) | (6,252,873) |
| **Consolidated assets** | **$ 44,109,111** | **$ 42,011,040** |

For the years ended December 31, 2010 and 2009, the Group did not have revenues from transactions with a single external customer amounting to 10% or more of the Group's consolidated revenues.

For the years ended December 31, 2010 and 2009, the Group's revenues outside of the RF were as follows:

| | 2010 | 2009 |
|---|---|---|
| Ukraine | $ 1,148,663 | $ 1,074,127 |
| Asia and Pacific region | 1,340,811 | 1,070,251 |
| Greece | 231,461 | 390,199 |
| Central and Eastern Europe | 191,847 | 74,935 |
| Other | 70,444 | 77,210 |
| **Total** | **$ 2,983,226** | **$ 2,686,722** |

As of December 31, 2010 and 2009, the Group's long-lived assets located outside of the RF were as follows:

| | 2010 | 2009 |
|---|---|---|
| Ukraine | $ 1,281,135 | $ 1,512,379 |
| Asia and Pacific region | 2,569,320 | 2,503,655 |
| Greece | 110,045 | 140,581 |
| Central and Eastern Europe | 101,952 | 130,043 |
| Other | 55,735 | 44,038 |
| **Total** | **$ 4,118,187** | **$ 4,330,696** |

## 23. RELATED PARTY TRANSACTIONS

The Group provides services to and purchases services from affiliates and companies related by means of common control. During the years ended December 31, 2010 and 2009, the Group entered into transactions with related parties as follows:

| | 2010 | 2009 |
|---|---|---|
| Sale of goods and services | $ (856,792) | $ (139,082) |
| Telecommunication services provided | (7,395) | (5,625) |
| Revenues from financial services | (11,554) | (21,782) |
| Cost of financial services | 14,043 | 2,342 |
| Telecommunication services purchased | 5,539 | 1,374 |
| Purchases of goods for resale | 2,558 | 712 |
| Other expenses | 72,164 | 44,252 |

The Group enters into transactions to purchase and sell goods and services from and to its related parties in the normal course of business.

Related party balances as of December 31, 2010 and, 2009 are disclosed in the corresponding notes to the financial statements.

## 24. STOCK BONUS AND STOCK OPTION PLANS

The Company, and several of its subsidiaries, operate share-based compensation plans in order to compensate their employees. This is done through either "equity" plans, in which employees may exercise their options for shares, and "phantom" plans, which generally allow employees to receive cash compensation which varies dependent on the share price that the options are linked to.

A summary of share-based compensation plans offered by the Company is as follows:

***JSFC Sistema Phantom Share Option Plan*** – In December 2007, JSFC Sistema launched a long-term incentive program for up to 110 of its senior and middle managers ("JSFC Sistema Phantom Share Option Plan"). Participants of the program were entitled to exercise options granted to them for a period of twelve months after the options cliff vest after three years. A total of up to 20,000 phantom share options related to the shares of JSFC Sistema, 996,000 phantom share options related to the shares of MTS, 1,190,500 phantom share options related to the shares of Comstar-UTS, and 45,455,000 phantom share options related to the shares of SITRONICS were granted under the plan. Upon vesting, the participants were entitled to cash compensation equal to the market price of the share at the time of exercise.

A summary of the status of the JSFC Sistema Phantom Share Option Plan in the years ended December 31, 2010 and 2009 is presented below:

| | Quantity | Exercise price, per share, USD | Weighted average fair value of options, USD |
|---|---|---|---|
| Outstanding at January 1, 2009 | 12,364,390 | 1.8 | 0.01 |
| Granted | 300 | 1.8 | 0.01 |
| Forfeited | (1,087,998) | 1.8 | 0.04 |
| Expired | - | - | - |
| Outstanding at December 31, 2009 | 11,276,692 | 1.8 | 0.13 |
| Granted | - | - | - |
| Forfeited | - | - | - |
| Expired | (11,276,692) | 1.8 | 0.13 |
| Outstanding at December 31, 2010 | - | - | - |

***JSFC Sistema Share-based Long-Term Motivation Program*** – In 2010, JSFC Sistema's Board of Directors established a three-year motivation program for senior management ("JSFC Sistema Share-based Long-Term Motivation Program"). According to the program, the participants are granted phantom shares of JSFC Sistema upon their continued employment with the Group. Participants can convert up to 2/3 of phantom shares granted into cash based on the weighted-average market price of the Company's ordinary shares at the MICEX for 60 trading days preceding the end of 2010. The rest will be converted into ordinary shares of JSFC Sistema in the beginning of 2012.

The grant-date fair value of an equity portion of the award was measured at the fair value of the Company's ordinary shares at that date and equated to $54.3 million. The liability portion of the award is remeasured at fair value at each reporting date, and was $59.7 million as of December 31, 2010.

In addition to the plans disclosed above, the Group has a number of share-based compensation plans in MTS, SITRONICS and Bashneft, not disclosed here on the basis of their lack of significance to the Group.

## 25. COMMITMENTS AND CONTINGENCIES

***Operating leases*** – The Group leases land, buildings and office space mainly from municipal organizations through contracts which expire in various years through 2058.

Rental expenses under the operating leases amounting to $495.7 million and $396.4 million for the year ended December 31, 2010 and 2009, respectively and are included in operating expenses. Rental expenses under the operating leases amounting to $182,4 million and $168.7 million for the year ended December 31, 2010 and 2009, respectively are included in cost of sales.

Future minimum rental payments under operating leases in effect as of December 31, 2010, are as follows:

| Year ended December 31, | | |
|---|---|---|
| 2011 | $ | 490,408 |
| 2012 | | 148,970 |
| 2013 | | 137,873 |
| 2014 | | 134,166 |
| 2015 | | 137,502 |
| Thereafter | | 230,194 |
| **Total** | **$** | **1,279,113** |

***Agreement with Apple*** – In August 2008, the Group entered into an unconditional purchase agreement with Apple Sales International to buy 1.5 million iPhone handsets at list prices at the dates of respective purchases over the three year period. Pursuant to the agreement the Group shall also incur certain iPhone promotion costs. In 2010 and 2009, the Group made 7.5% and 0.4% of its total purchase installments contemplated by the agreement, respectively.

The total amount paid for handsets purchased under the agreement for the years ended December 31, 2010 and 2009 amounted to $79.4 and $3.4 million, respectively.

***Capital commitments*** – As of December 31, 2010, the Group had executed purchase agreements of approximately $320.5 million to acquire property, plant and equipment, intangible assets and costs related thereto.

***Operations in Turkmenistan*** – In December 2010 the Group suspended its operations in Turkmenistan following a notice received from the Ministry of Communications of Turkmenistan informing of a decision to suspend licenses held by BCTI, the Group's wholly-owned subsidiary in Turkmenistan, for a period of one month starting from December 21, 2010. On January 21, 2011 period of license suspension expired but no permission to resume operations was granted.

The Group conducted operations in Turkmenistan under a trilateral agreement signed in November 2005 by BCTI, MTS OJSC and the Ministry of Communications of Turkmenistan which expired on December 21, 2010 and was not extended. In accordance with certain provisions of this agreement, BCTI shared net profit derived from its operations in the country with the Ministry of Communications of Turkmenistan. The amount of shared net profit was calculated based on the financial statements prepared in accordance with local accounting principles subject to certain adjustments. Under the terms of the agreement, BCTI shared 49% of the net profit since the date of its acquisition by the Group through December 21, 2005, and 20% of the net profit commencing December 21, 2005. The Group at all times believed that the agreement would be extended and approached the Ministry of Communications within the required timeframe to formalize the extension. However, the Ministry of Communications failed to grant the extension in accordance with the terms of the agreement.

Following the decision to suspend licenses, Turkmenistan government authorities took some additional steps, including one-sided termination of interconnect agreements between BCTI and state-owned telecom operators, to prevent the Group from providing services to its customers.

Although BCTI have experienced no restrictions in using its current bank accounts and short-term deposits to settle existing tax and contractural liabilities, the ability of the Group to repatriate cash from the country is uncertain.

The Group has initiated a number of lawsuits against Turkmenistan government authorities and state-owned telecom operators to defend its legal rights. On December 21, 2010 BCTI filed three requests of arbitration with the International Court of Arbitration of the International Chamber of Commerce ("ICC") against the Ministry of Communications of Turkmenistan and several state-owned telecom operators requesting specific performance on the respective agreements and compensation of damages. On January 24, 2011 ICC proceedings were suspended due to the proposal of the Ministry of Communications of Turkmenistan to start negotiations but were resumed on February 18, 2011 as no agreement between the parties was reached.

On January 21, 2011, MTS sent to the Government of Turkmenistan a formal notice requesting to resolve the dispute by negotiations. Should the dispute not be resolved amicably by negotiations, MTS reserved its right to commence proceedings against the sovereign state of Turkmenistan on the basis of any applicable inter-governmental investment treaty. Under the Bilateral Investment Treaty ("BIT") between the Russian Federation and Turkmenistan, if a dispute is not resolved through negotiations within six months from the date of the request to negotiate, it can be referred to the International Centre for the Settlement of Investment Disputes ("ICSID").

Considering the adverse influence of the circumstances on the Group's ability to conduct operations in Turkmenistan, the Group determined that all of its long-lived assets attributable to Turkmenistan were impaired and recorded an impairment charge of $119.6 million in the consolidated statement of operations for the year ended December 31, 2010. The Group also assessed the recoverability of the subsidiary's current assets and provided for or wrote down those which were considered to be impaired. The total effect of impairment charges on the Group's statement of operations for the year ended December 31, 2010 was $137.8 million.

***MGTS long-term investment program*** – In December 2003, MGTS announced its long-term investment program for the period from 2004 to 2012, providing for extensive capital expenditures, including expansion and full digitalization of the Moscow telephone network. The program was approved by the resolution of the Moscow City Government on December 16, 2003. At the inception of the investment program, capital expenditures were estimated to be approximately $1,600.0 million and included reconstruction of 350 local telephone stations and installation of 4.3 million of new phone lines. As a result of implementation of the investment program, new digital equipment is being installed in the buildings housing the telephone nodes, and a substantial amount of floor space will become available after the replacement of analogue switching equipment. The additional free floor space after reconstruction is expected to be sold to third parties or rented out. There are 113 automatic telephone station buildings which are to be reconstructed or rebuilt in the course of the investment program. Currently, the management had not made a decision whether to sell the free floor space created in the course of the investment program or to rent it out.

In November 2006, MGTS signed an agreement with the Moscow City Government, under which MGTS' investment program was approved. Under the agreement, the Moscow City Government is entitled to receive not less than 30% of the market value of additional floor space constructed during the course of the investment program. The obligation arises at the time the reconstruction of specified properties is completed. In December 2005, MGTS made a prepayment to the Moscow City Government under this program which will be offset against the future liability arising as a result of the investment program.

In the course of implementation of the investment program, MGTS entered into a series of agreements with Sistema-Hals, a former subsidiary of Sistema, related to project development and reconstruction of buildings housing the telephone stations. The main part of the work under these contracts was to be performed between 2006 and 2012. Under the agreements, Sistema-Hals was to prepare the project documentation and perform construction works on behalf of MGTS, and MGTS was to reimburse all the expenses incurred in relation to the construction process with a margin of 4.75% on such expenses and to pay a fixed fee of $0.04 million per one building. During 2005-2009 project development and site preparation works were performed by Sistema Hals on 95 sites, which resulted in recognition of payable to Sistema Hals and construction in-progress amounted to $39.3 million and $33.3 million as of December 31, 2010, respectively.

In February 2009, the Board of Directors of MGTS approved the cancellation of agreements with Sistema-Hals with respect to 26 sites, which also extinguishes the respective portion of MGTS' liability to Sistema-Hals, and signing of 26 new agreements with other non-related companies. Under the new agreements, the investor companies would perform all necessary reconstruction work and obtain the property rights for the reconstructed buildings except for the premises locating the digitalized nodes which would remain MGTS property. In addition, within 12 months after transfer of the building into the investment project, MGTS is to receive cash payment equal to MGTS' share in the value of the building before reconstruction as appraised by an independent valuation firm in 2008, plus interest at 20% per annum accrued for the period from transfer of the building into the project and the date of payment. As of December 31, 2009, 2 out of aforementioned 26 agreements was cancelled.

In December 2010, MGTS and Sistema Hals cancelled agreements in connection with 87 sites out of 95. The agreed terms for the cancelled agreements are as follows:

- For 8 out of 87 sites all the expenses incurred by Sistema Hals in relation to construction process on those sites should be reimbursed by investor companies, not MGTS. Consequently, payable to Sistema Hals and construction in-progress in connection with these sites of $20.8 million and $17.7 million, respectively, were reversed as of December 31, 2010.
- For 79 out of 87 sites MGTS agreed to reimburse part of the expenses incurred by Sistema Hals in relation to the construction process. Consequently, payable to Sistema Hals and construction in progress related to those 79 sites were reduced by $6.4 million and $5.5 million respectively, and, as of December 31, 2010, amounted to $5.9 million and $5.0 million respectively. In addition, management believes that the remaining capital expenditures are impaired as of December 31, 2010 by the amount of $3.5 million.

The remaining 8 sites will be developed based on existing agreements. Accordingly, as of December 31, 2010, the respective payable to Sistema Hals and construction in-progress amounted to $6.1 million and $5.2 million respectively.

***Other commitments*** – As of December 31, 2010 MBRD and its subsidiaries guaranteed loans for several companies, including related parties, which totaled $146.1 million. JSFC Sistema guaranteed loans for a few related companies in total amount of $250.8 million.

These guarantees would require payment by the Group only in the event of default on payment by the respective debtor. As of December 31, 2010, no event of default has occurred under any of the guarantees issued by the Group.

The Central Bank of Russia sets minimum capital requirements for banks. The minimum capital requirement is set at Euro 5.0 million (equivalent of $6.9 million as of December 31, 2010) for each bank. As of December 31, 2010, MBRD's share capital amounted to 1,360.9 million RUB (equivalent to $44.6 million as of December 31, 2010).

***Taxation*** – Russia and the CIS countries currently have a number of laws related to various taxes imposed by both federal and regional governmental authorities. Applicable taxes include VAT, corporate income tax (profits tax), a number of turnover-based taxes, and payroll (social) taxes. Laws related to these taxes have not been in force for significant periods, in contrast to more developed market economies; therefore, the government's implementation of these regulations is often inconsistent or nonexistent. Accordingly, few precedents with regard to tax rulings have been established. Tax declarations, together with other legal compliance areas (for example, customs and currency control matters), are subject to review and investigation by a number of authorities, which are enabled by law to impose extremely severe fines, penalties and interest charges. These facts create tax risks in Russia and the CIS countries that are more significant than typically found in countries with more developed tax systems.

Generally, according to Russian tax legislation, tax declarations remain open and subject to inspection for a period of three years following the tax year. As of December 31, 2010, tax declarations of OJSC MTS and other subsidiaries in Russia for the preceding three fiscal years were open for further review.

In October 2009, the Russian tax authorities completed the tax audit of Sibintertelecom for the years ended December 31, 2006, 2007 and 2008. Based on the results of this audit, the Russian tax authorities assessed that RUB 174.5 million ($5.8 million as of December 31, 2009) of additional taxes, penalties and fines were payable by the Group. The resolution had not come into force as the Group has prepared and filed an appeal with the Federal Tax Service to recognize the tax authorities' resolution to be invalid. The Group succeeded in action in court of original jurisdiction, which recognized the tax authorities' resolution to be invalid. In February 2010 arbitration appellate court confirmed the decision of the court of original jurisdiction.

In December 2010 the Russian tax authorities completed the tax audit of MTS OJSC for the years ended December 31, 2007 and 2008. Based on the results of this audit, the Russian tax authorities assessed that RUB 353.9 million ($11.6 million as of December 31, 2010) of additional taxes, penalties and fines were payable by the Group.

The Group purchases supplemental software from foreign suppliers of telecommunication equipment in the ordinary course of business. The Group's management believes that custom duties are calculated in compliance with the applicable legislation. However there is a risk that the customs authorities may take a different view and impose additional custom duties. As of December 31, 2010 and 2009, no provision was recorded in the consolidated financial statements in respect of such additional duties.

Pricing of revenue and expenses between each of the Group's subsidiaries and various discounts and bonuses to Group's subscribers in the course of performing its marketing activities might be a subject to transfer pricing rules. The Group's management believes that taxes payable are calculated in compliance with the applicable tax regulations relating to transfer pricing. However there is a risk that the tax authorities may take a different view and impose additional tax liabilities. As of December 31, 2010 and 2009, no provision was recorded in the consolidated financial statements in respect of such additional claims.

Management believes that it has adequately provided for tax and customs liabilities in the accompanying consolidated financial statements. As of December 31, 2010 and 2009, the provision accrued amounted to $10.0 million and $68.2 million, respectively. In addition, the accrual for unrecognized income tax benefits, potential penalties and interest recorded in accordance with the authoritative guidance on income taxes totaled $17.8 million and $15.3 million as of December 31, 2010 and 2009, respectively. However, the risk remains that the relevant authorities could take different positions with regard to interpretive issues and the effect could be significant.

In addition, the Group had a number of claims and litigations relating to sales and purchases of goods and services. Management estimates possible adverse effect on financial result of these claims in the amount of $50.0 and $nil million as of December 31, 2010 and 2009, respectively.

With regard to matters where practice concerning payment of taxes is unclear in respect of Oil and Energy segment operations, management estimated possible tax exposure at December 31, 2010, to be approximately of $184.0 million (December 31, 2009: $121.0 million).

***3G license*** – In May 2007, the Federal Service for Supervision in the Area of Communications and Mass Media awarded MTS a license to provide 3G services in the Russian Federation. The 3G license was granted subject to certain capital and other commitments. The major conditions are that MTS will have to build a certain number of base stations that support 3G standards and will have to start providing services in the Russian Federation by certain date, and also will have to build a certain number of base stations by the end of the third, fourth and fifth years from the date of granting the license. Management believes that as of December 31, 2010 MTS is in compliance with these conditions.

***Operating licenses in India*** – The Center for Public Interest Litigation, an Indian non-govermental not-for-profit organization, has filed a petition by seeking appropriate writ for cancellation of entire allocation of 2G spectrum and telecom licenses made by Department of Telecommunication on or after January 10, 2008. This petition is based on the Audit Report of the Controller and Auditor General of India on the spectrum allocation and grant of Telecom licenses. Management believes that there was no violation of the legislation and no amounts have been accrued in the accompanying consolidated financial statements in relation to this petition.

***Bitel*** – In December 2005, MTS Finance acquired a 51.0% stake in Tarino Limited ("Tarino"), from Nomihold Securities Inc. ("Nomihold"), for $150.0 million in cash based on the belief that Tarino was at that time the indirect owner, through its wholly owned subsidiaries, of Bitel LLC ("Bitel"), a Kyrgyz company holding a GSM 900/1800 license for the entire territory of Kyrgyzstan.

Following the purchase of the 51.0% stake, MTS Finance entered into a put and call option agreement with Nomihold for "Option Shares," representing the remaining 49.0% interest in Tarino shares and a proportional interest in Bitel shares. The call option was exercisable by MTS Finance from November 22, 2005 to November 17, 2006, and the put option was exercisable by Nomihold from November 18, 2006 to December 8, 2006. The call and put option price was $170.0 million.

Following a decision of the Kyrgyz Supreme Court on December 15, 2005, Bitel's corporate offices were seized by a third party. As the Group did not regain operational control over Bitel's operations in 2005, it accounted for its 51.0% investment in Bitel at cost as at December 31, 2005. The Group appealed the decision of the Kyrgyz Supreme Court in 2006, but the court did not act within the time period permitted for appeal. The Group subsequently sought the review of this dispute over the ownership of Bitel by the Prosecutor General of Kyrgyzstan to determine whether further investigation could be undertaken by the Kyrgyz authorities.

In January 2007, the Prosecutor General of Kyrgyzstan informed the Group that there were no grounds for involvement by the Prosecutor General's office in the dispute and that no legal basis existed for the Group to appeal the decision of the Kyrgyz Supreme Court. Consequently, the Group decided to write off the costs relating to the purchase of the 51.0% stake in Bitel, which was reflected in its audited annual consolidated financial statements for the year ended December 31, 2006. Furthermore, with the impairment of the underlying asset, a liability of $170.0 million was recorded with an associated charge to non-operating expenses.

In November 2006, MTS Finance received a letter from Nomihold purporting to exercise the put option and sell the Option Shares for $170.0 million to MTS Finance. In January 2007, Nomihold commenced an arbitration proceeding against MTS Finance in the London Court of International Arbitration in order to compel MTS Finance to purchase the Option Shares. Nomihold sought specific performance of the put option, unspecified monetary damages, interest, and costs. In January 2011 London Court of International Arbitration made an award in favor of Nomihold satisfying Nomihold's specific performance request and ordered MTS Finance to pay to Nomihold $170.0 million for Option Shares, $5.9 million in damages, $34 million of interest and costs – all representing in total approximately $210.0 million ("Award"). In addition to the $170.0 million liability related to this case and accrued in the year ended December 31, 2006, the Group recorded an additional $40.8 million in the consolidated financial statements for the year ended December 31, 2010.

In addition, three Isle of Man companies affiliated with the Group (the "KFG Companies"), have been named defendants in lawsuits filed by Bitel in the Isle of Man seeking the return of dividends received by these three companies in the first quarter of 2005 from Bitel in the amount of approximately $25.2 million plus compensatory damages, and to recover approximately $3.7 million in losses and accrued interest. In the event that the defendants do not prevail in these lawsuits, the Group may be liable to Bitel for such claims. The KFG Companies have also asserted counterclaims against Bitel, and claims against other defendants including Altimo LLC ("Altimo"), and Altimo Holdings & Investments Limited ("Altimo Holding"), for the wrongful misappropriation and control of Bitel.

On November 30, 2007 the High Court of Justice of the Isle of Man set aside orders it had previously issued granting leave to serve the non-Manx defendants out of the jurisdiction as to the KFG Companies' counterclaims on the basis of a lack of jurisdiction. The KFG Companies appealed that ruling to the Isle of Man Staff of Government and on November 28, 2008, the Staff of Government reversed the High Court and ruled that the case should proceed in the Isle of Man. The defendants have sought leave to appeal from the Judicial Committee of the Privy Council of the House of Lords of the United Kingdom.

On March 10, 2011 the Judicial Committee of the UK Privy Council ruled in favor of the KFG Companies. The Privy Council's ruling confirms the jurisdiction of the Isle of Man courts to try the counterclaims asserted by the KFG Companies against various defendants, including "Sky Mobile" LLC, Altimo and Altimo Holdings, for the wrongful misappropriation and seizure of Kyrgyz telecom operator Bitel and its assets.

In a separate arbitration proceeding initiated against the KFG Companies by Kyrgyzstan Mobitel Investment Company Limited ("KMIC"), under the rules of the London Court of International Arbitration, the arbitration tribunal in its award found that the KFG Companies breached a transfer agreement dated May 31, 2003 (the "Transfer Agreement"), concerning the shares of Bitel. The Transfer Agreement was made between the KFG Companies and IPOC International Growth Fund Limited ("IPOC"), although IPOC subsequently assigned its interest to KMIC, and KMIC was the claimant in the arbitration. The tribunal ruled that the KFG Companies breached the Transfer Agreement when they failed to establish a date on which the equity interests in Bitel were to be transferred to KMIC and by failing to take other steps to transfer the Bitel interests. This breach occurred prior to MTS Finance's acquisition of the KFG Companies. The arbitration tribunal ruled that KMIC is entitled only to damages in an amount to be determined in future proceedings. At the request of the parties, the tribunal agreed to stay the damages phase of the proceedings pending the resolution of the appeals process before the court in the Isle of Man, as described above. The Group is not able to predict the outcome of these proceedings or the amount of damages to be paid, if any.

***Other*** – In the ordinary course of business, the Group may be party to various legal proceedings, and subject to claims, certain of which relate to the developing markets and evolving fiscal and regulatory environments in which the Group operates. In the opinion of management, the Group's liability, if any, in all pending litigations, other legal proceedings or other matters will not have a material effect upon the financial condition, results of operations or liquidity of the Group.

## 26. SUBSEQUENT EVENTS

***Transactions with Intourist shares*** – In November 2010, OJSC Intourist (a subsidiary of the Group) and Thomas Cook Group Plc agreed to establish a new entity for Intourist's tour operating and retail businesses and a sale of a 50.1% stake in the newly formed entity to Thomas Cook for a total stock and cash consideration of $45 million. The new entity will include Intourist's tour operating and retail businesses. Intourist will have a 49.9% stake in the new entity while Thomas Cook will acquire a 50.1% stake in the joint venture for a total consideration of $45 million of which $10 million is to be payable in cash and $35 million due in Thomas Cook's shares listed on the London Stock Exchange (based on the average share price for twenty trading days preceding completion of the deal). Intourist will retain its hotel business. In addition, Thomas Cook and Intourist entered into an option agreement exercisable over the next five years under which Thomas Cook may call, and Intourist may put, Intourist's remaining shares in the new company. As of April 26, 2011 the new entity was not established.

***Acquisition of MGTS shares*** – In February 2011, CJSC Sistema-Inventure, a wholly-owned subsidiary of Sistema JSFC, acquired more than 1% of the ordinary shares of MGTS at a price of RUB 436.20 per share, for total cash consideration of RUB 370 million (approximately $12.3 million). The purchase was made in accordance with the mandatory tender offer announced by Sistema JSFC on November 13, 2010.

***Transaction with Bank of Moscow*** – In February 2011, the previously announced transaction between Sistema and Bank of Moscow to establish OJSC RTI following the receipt of the Federal Antimonopoly Services permission and issuance of 84.6% of the share capital of the newly established company to Sistema and 15.4% to the Bank of Moscow was completed.

***Acquisition of Trebs and Titov licenses*** – In February 2011, Bashneft acquired licenses on oil fields named after Trebs and Titov for RUB 18.5 billion (approximately $598.0 million as of the date of transaction). As of December 31, 2010 the whole amount was classified as advance payment for non-current assets.

***Pekin Hotel*** – In February 2011, the Group sold its stake in Pekin Hotel to Sistema Hals for a total consideration of $58.2.

***Sale of SITRONICS shares*** – In March 2011, Sistema's Board of Directors has approved the sale of Sistema's stake in OJSC SITRONICS ("SITRONICS") to OJSC RTI ("RTI"). In accordance with the proposal, Sistema's Board of Directors approved the sale of the Company's stake of approximately 63% in SITRONICS to RTI for $0.9228 per GDR (based on the three-month weighted average price for GDR of SITRONICS on the LSE). To facilitate the transaction, Sistema's Board of Directors has also approved the extension of a short-term loan by Sistema to RTI.

***New President of JSFC Sistema*** – In March 2011, Sistema's Board of Directors has appointed Mikhail Shamolin, the former President and CEO of Mobile TeleSystems (MTS), as President of Sistema. Leonid Melamed, who has been President of Sistema for three years, will continue to serve as a member of Sistema's Board of Directors and Chairman of RussNeft.

***SITRONICS-Nano letter of credit*** – In March 2011, SITRONICS announced that the Bank of Moscow and SITRONICS-Nano signed an agreement for issuance of an unsecured irrevocable letter of credit with post-financing in favor of STMicroelectronics for license and technology transfer to SITRONICS-Nano in the amount of EUR 27 million. The rate of interest relating to this letter of credit is EURIBOR+5% and the term of the contract is 3 years with potential to extend for another 3 years. SITRONICS and Mikron are guarantors to this facility.

***Bonds offering*** – In March 2011, Sistema has completed its purchase of non-convertible amortizing Series 02 and Series 03 bonds with a par value of RUB 1,000 each. Following the tender, 8,641,660 Series 02 bonds and 10,858,340 Series 03 bonds were acquired at nominal value for the total amount of RUB 19.5 billion ($0.6 billion as of December 31, 2010). The Series 02 and Series 03 bonds were due in 2014 and 2016, respectively. At the same time the Group has successfully placed RUB 19.5 billion of non-convertible amortizing Series 04 five-year bonds with a coupon rate of 7.65% for the ten semi-annual coupon payments. The bonds are due in 2016.

***Acquisition of Orenburgnefteproduct*** – In April 2011, Bashneft acquired from OJSC NK “RussNeft” a 94% stake in OJSC “Orenburgnefteproduct”, a company engaged in wholesale and retail of oil products in Orenburg region. Cash consideration included $90 million of fixed payment and additional payment equal to net working capital of the acquired company. Additional payment should be defined within 30 days after acquisition.

The Group management has evaluated subsequent events through April 26, 2011, the date when its financial statements were issued.

## 27. SUPPLEMENTARY INFORMATION ON OIL AND GAS EXPLORATION AND PRODUCTION ACTIVITIES (UNAUDITED)

This section provides unaudited supplemental information on oil and gas exploration and production activities in accordance with ASC No. 932 Extractive Activities – Oil and Gas, subtopic 235, Note to Financial Statements (ASC No. 932) in six separate tables:

I. Capitalized costs relating to oil and gas producing activities;
II. Costs incurred in oil and gas property acquisition, exploration, and development activities;
III. Results of operations for oil and gas producing activities;
IV. Reserve quantity information;
V. Standardized measure of discounted future net cash flows;
VI. Principal sources of changes in the standardized measure of discounted future net cash flows.

Amounts shown for equity companies represent the Group’s share in its exploration and production affiliates, which are accounted for using the equity method of accounting.

### *I. Capitalized costs relating to oil and gas producing and exploration activities*

| **As of December 31, 2010** | **Consolidated subsidiaries** | **Group’s share in equity investees** |
|---|---|---|
| Unproved oil and gas properties | $ 48,799 | $ - |
| Proved oil and gas properties | 3,693,491 | 2,020,998 |
| Accumulated depreciation, depletion and amortization | (315,900) | (414,135) |
| **Net capitalized costs** | **$ 3,426,390** | **$ 1,606,863** |

| **As of December 31, 2009** | **Consolidated subsidiaries** | **Group’s share in equity investees** |
|---|---|---|
| Unproved oil and gas properties | $ 13,230 | $ - |
| Proved oil and gas properties | 3,391,997 | - |
| Accumulated depreciation, depletion and amortization | (136,428) | - |
| **Net capitalized costs** | **$ 3,268,799** | **$ -** |

### *II. Costs incurred in oil and gas property acquisition, exploration, and development activities*

| **Year ended December 31, 2010** | **Consolidated subsidiaries** | **Group’s share in equity investees** |
|---|---|---|
| Acquisition of proved properties | $ - | $ 13,028 |
| Acquisition of unproved properties | 48,799 | - |
| Exploration costs | 8,004 | 3,775 |
| Development costs | 240,321 | 66,370 |
| **Total costs incurred** | **$ 297,124** | **$ 83,173** |

| **Nine months ended December 31, 2009** | **Consolidated subsidiaries** | **Group’s share in equity investees** |
|---|---|---|
| Acquisition of proved properties | $ 2,818,001 | $ - |
| Acquisition of unproved properties | - | - |
| Exploration costs | 13,230 | - |
| Development costs | 162,069 | - |
| **Total costs incurred** | **$ 2,993,300** | **$ -** |

### *III. Results of operations for oil and gas producing activities*

The Group's results of operations for oil and gas producing activities are presented below. In accordance with ASC No. 932, transfers to Group companies are based on market prices estimated by management. Income taxes are based on statutory rates. The results of operations exclude corporate overhead and interest costs.

| **Year ended December 31, 2010** | | **Consolidated companies** | | **Group's share in equity investees** |
|---|---|---|---|---|
| Revenue | | | | |
| Sales | $ | 984,403 | $ | 471,682 |
| Transfers | | 2,343,576 | | 188,737 |
| Total revenues | $ | 3,327,979 | $ | 660,419 |
| Production costs (excluding production taxes) | | (623,800) | | (129,909) |
| Exploration expenses | | (8,004) | | (2,516) |
| Depreciation, depletion and amortization | | (170,612) | | (57,313) |
| Accretion expense | | (11,969) | | (839) |
| Taxes other than income taxes | | (1,257,987) | | (254,785) |
| Related income taxes | | (251,121) | | (47,642) |
| **Total results of operation of producing activities** | $ | **1,004,486** | $ | **167,415** |

| **Nine months ended December 31, 2009** | | **Consolidated companies** | | **Group's share in equity investees** |
|---|---|---|---|---|
| Revenue | | | | |
| Sales | $ | 1,296,753 | $ | - |
| Transfers | | 762,361 | | - |
| Total revenues | $ | 2,059,114 | $ | - |
| Production costs (excluding production taxes) | | (347,050) | | - |
| Exploration expenses | | (9,699) | | - |
| Depreciation, depletion and amortization | | (115,212) | | - |
| Accretion expense | | (9,611) | | - |
| Taxes other than income taxes | | (698,775) | | - |
| Related income taxes | | (120,100) | | - |
| **Total results of operation of producing activities** | $ | **758,667** | **$** | **-** |

### *IV. Reserve quantity information*

Proved reserves are the estimated quantities of oil and gas reserves for which geological and engineering data demonstrate their recoverability with reasonable certainty in future years from known reservoirs under existing economic and operating conditions. In accordance with ASC No. 932 existing economic and operating conditions are based on the 12-months average price. Proved reserves do not include additional quantities of oil and gas reserves that may result from applying secondary or tertiary recovery techniques not yet tested and determined to be economic.

Proved developed reserves are the quantities of proved reserves expected to be recovered through existing wells with existing equipment and operating methods.

Due to the inherent uncertainties and the necessarily limited nature of reservoir data, estimates of reserves are inherently imprecise, require the application of judgment and are subject to change as additional information becomes available.

Management has included within proved reserves significant quantities which the Group expects to produce after the expiry dates of certain of its current production licenses in the Russian Federation. The Subsoil Law of the Russian Federation states that, upon expiration, a license is subject to renewal at the initiative of the license holder provided that further exploration, appraisal, production or remediation activities are necessary and provided that the license holder has not violated the terms of the license. The law applies both to newly issued and old licenses and the management believes that licenses will be renewed upon their expiration for the remainder of the economic life of each respective field.

Estimated net proved oil and gas reserves and changes thereto from the March 31, 2009 to December 31, 2009 and for the year ended December 31, 2010 are shown in the tables set out below.

| **Thousands of barrels (proved developed and undeveloped reserves)** | | **Consolidated subsidiaries** | | **Group's share in equity investees** |
|---|---|---|---|---|
| **Crude oil** | | | | |
| March 31, 2009 | $ | 1,667,600 | $ | - |
| Revisions of previous estimates | | 179,775 | | - |
| Extensions and discoveries | | 14,200 | | - |
| Production | | (66,475) | | - |
| Sales of reserves | | - | | - |
| **December 31, 2009** | **$** | **1,795,100** | **$** | **-** |
| Acquisition of equity stake in RussNeft | | - | | 462,458 |
| Revisions of previous estimates | | 181,512 | | 36,298 |
| Purchase of hydrocarbons in place | | - | | 3,903 |
| Extensions and discoveries | | - | | - |
| Production | | (100,712) | | (20,886) |
| Sales of reserves | | - | | - |
| **December 31, 2010** | **$** | **1,875,900** | **$** | **481,773** |
| Proved developed reserves | | | | |
| **March 31, 2009** | **$** | **1,625,112** | **$** | **-** |
| **December 31, 2009** | **$** | **1,728,473** | **$** | **-** |
| **December 31, 2010** | **$** | **1,763,800** | **$** | **323,946** |
| Proved undeveloped reserves | | | | |
| **March 31, 2009** | **$** | **42,488** | **$** | **-** |
| **December 31, 2009** | **$** | **66,627** | **$** | **-** |
| **December 31, 2010** | **$** | **112,100** | **$** | **157,828** |

The noncontrolling interest included in the above total proved reserves was 506,493 thousand barrels and 484,677 thousand barrels as of December 31, 2010 and 2009, respectively. The noncontrolling interest included in the above proved developed reserves was 476,199 thousand barrels and 466,688 thousand barrels as of December 31, 2010 and 2009, respectively.

The Company's proved oil reserves are located entirely in the Russian Federation.

### *V. Standardized measure of discounted future net cash flows*

The standardized measure of discounted future net cash flows, related to oil and gas reserves in the Group's most significant oil fields, is calculated in accordance with the requirements of ASC No. 932. Estimated future cash inflows from production are computed by applying the 12-months average price for oil and gas to year-end quantities of estimated net proved reserves. Adjustment in this calculation for future price changes is limited to those required by contractual arrangements in existence at the end of each reporting year. Future development and production costs are those estimated future expenditures necessary to develop and produce year-end estimated proved reserves based on year-end cost indices, assuming continuation of year-end economic conditions. Estimated future income taxes are calculated by applying appropriate year-end statutory tax rates. These rates reflect allowable deductions and tax credits and are applied to estimated future pre-tax net cash flows, less the tax bases of related assets. Discounted future net cash flows have been calculated using a ten percent discount factor. Discounting requires a year-by-year estimate of when future expenditures will be incurred and when reserves will be produced.

The information provided in the tables set out below does not represent management's estimate of the Group's expected future cash flows or of the value of the Group's proved oil and gas reserves. Estimates of proved reserve quantities are imprecise and change over time as new information becomes available. Moreover, probable and possible reserves, which may become proved in the future, are excluded from the calculations. The arbitrary valuation prescribed under ASC No. 932 requires assumptions as to the timing and amount of future development and production costs. The calculations should not be relied upon as an indication of the Group's future cash flows or of the value of its oil and gas reserves.

| As of December 31, 2010 | | Total consolidated companies | | Group's share in equity investees |
|---|---|---|---|---|
| Future cash inflows | $ | 66,653,165 | $ | 14,655,812 |
| Future production and development costs | | (36,263,017) | | (9,298,014) |
| Future income tax expenses | | (6,078,030) | | (1,071,560) |
| Future net cash flows | $ | 24,312,118 | $ | 4,286,238 |
| Discount for estimated timing of cash flows (10% p.a) | | (15,216,083) | | (2,357,737) |
| Discounted future net cash flows | $ | 9,096,035 | $ | 1,928,501 |
| Noncontrolling interest in discounted future net cash flows | $ | 2,455,929 | | |

| As of December 31, 2009 | | Total consolidated companies | | Group's share in equity investees |
|---|---|---|---|---|
| Future cash inflows | $ | 34,444,850 | $ | - |
| Future production and development costs | | (20,892,354) | | - |
| Future income tax expenses | | (2,710,499) | | - |
| Future net cash flows | $ | 10,841,997 | $ | - |
| Discount for estimated timing of cash flows (10% p.a) | | (6,824,445) | | - |
| Discounted future net cash flows | $ | 4,017,552 | $ | - |
| Noncontrolling interest in discounted future net cash flows | $ | 1,084,739 | | |

### *VI. Principal sources of changes in the standardized measure of discounted future net cash flows*

| Consolidated companies | | 2010 | | 2009 |
|---|---|---|---|---|
| **Discounted present value as at January 1, 2010 and March 31, 2009** | **$** | **4,017,552** | **$** | **2,110,046** |
| Sales and transfers of oil and gas produced, net of production costs and taxes other than income tax | | (1,438,187) | | (1,003,589) |
| Net changes in prices and production costs estimates | | 4,235,993 | | 3,387,078 |
| Net changes in mineral extraction taxes | | (1,442,021) | | (1,176,304) |
| Development costs incurred during the period | | 240,321 | | 162,069 |
| Changes in estimated future development costs | | (419,299) | | (384,829) |
| Revisions of previous quantity estimates | | 2,180,360 | | 771,135 |
| Net changes in income taxes | | (758,859) | | (385,297) |
| Other changes | | 2,043,045 | | 366,316 |
| Accretion of discount | | 437,130 | | 170,927 |
| **Discounted present value at December 31** | **$** | **9,096,035** | **$** | **4,017,552** |

| Group's share in equity investees | | 2010 |
|---|---|---|
| **Discounted present value as at April 30,** | **$** | **2,220,905** |
| Net changes due to purchases of minerals in place | | 19,392 |
| Sales and transfers of oil and gas produced, net of production costs | | (273,208) |
| Net changes in prices and production costs estimates | | 38,964 |
| Net changes in mineral extraction taxes | | (434,834) |
| Extensions and discoveries, less related costs | | - |
| Development costs incurred during the period | | 58,047 |
| Changes in estimated future development costs | | 47,719 |
| Revisions of previous quantity estimates | | 49,463 |
| Net changes in income taxes | | 75,606 |
| Other changes | | (11,802) |
| Accretion of discount | | 168,691 |
| **Discounted present value at December 31** | **$** | **1,958,943** |