# Open Joint Stock Company
# Far East Telecommunications Company

Consolidated Financial Statements

*For the year ended December 31, 2005*
*with Independent Auditor's Report*

# OJSC Far East Telecommunications Company

## Consolidated Financial Statements

## For the year ended December 31, 2005

**Contents**

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# Independent Auditors' Report

To the Shareholders and Board of Directors of OJSC Far East Telecommunications Company

1. We have audited the accompanying consolidated balance sheet of OJSC Far East Telecommunications Company (a Russian open joint-stock company - hereinafter "the Company") as of December 31, 2005, and the related consolidated statements of operations, cash flows and changes in shareholders' equity for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

2. Except as discussed in paragraph 3, we conducted our audit in accordance with International Standards on Auditing issued by the International Federation of Accountants. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

3. As described in Note 2 "Basis of Presentation of the Financial Statements", the Company transitioned to International Financial Reporting Standards (IFRS) at January 1, 2003 and applied an exemption in IFRS 1, "First-time Adoption of International Financial Reporting Standards", which permits to measure property, plant and equipment at the date of transition to IFRS at fair value and use that fair value as deemed cost. However, we were not able to satisfy ourselves as to whether the carrying amounts of property, plant and equipment as at January 1, 2003 were representative of fair value. Accordingly, we were unable to determine whether the carrying value of property, plant and equipment as of December 31, 2005 and 2004 complies with the requirements of IFRS. Further, we were unable to satisfy ourselves as to the related (i) depreciation expense for the years presented and (ii) the deferred tax balances as of December 31, 2005 and 2004 and deferred tax expense for the years presented.

4. In our opinion, except for the effects of such adjustments, if any, which might have been determined to be necessary had we been able to satisfy ourselves as to the matters referred to in paragraph 3, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2005, and the consolidated results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

June 16, 2006 Ernst & Young LLC

# OJSC Far East Telecommunications Company

## Consolidated Balance Sheet as of December 31, 2005

*(in thousands roubles)*

| | Notes | December 31, 2005 | 2004 as restated |
|---|---|---|---|
| **ASSETS** | | | |
| **Noncurrent assets** | | | |
| Property, plant and equipment, net | **5** | 11,048,301 | 10,144,826 |
| Intangible assets and goodwill, net | **6** | 812,444 | 532,364 |
| Investments in associates | **8** | 25,969 | 26,303 |
| Long–term investments, net | **9** | 7,432 | 3,486 |
| Long–term accounts receivable and other assets | **10** | 23,154 | 25,305 |
| Long–term advances given | **11** | 279,940 | 137,748 |
| **Total noncurrent assets** | | **12,197,240** | **10,870,032** |
| **Current assets** | | | |
| Inventories | **12** | 382,858 | 436,563 |
| Accounts receivable, net | **13** | 826,569 | 632,049 |
| Current income tax asset | | 6,414 | 126,249 |
| Short–term investment, net | **9** | 886 | 223,422 |
| Other current assets, net | **14** | 556,028 | 550,208 |
| Cash and cash equivalents | **15** | 158,331 | 129,210 |
| **Total current assets** | | **1,931,086** | **2,097,701** |
| **TOTAL ASSETS** | | **14,128,326** | **12,967,733** |
| **EQUITY AND LIABILITIES** | | | |
| **Equity attributable to equity holders of the parent** | | | |
| Share capital | **17** | 4,365,706 | 4,365,706 |
| Unrealized gain on available–for–sale investments | | – | 158,829 |
| Retained earnings | | 2,479,030 | 2,093,212 |
| **Total equity attributable to equity holders of the parent** | | **6,844,736** | **6,617,747** |
| **Minority interest** | | 11,699 | – |
| **Total equity** | | **6,856,435** | **6,617,747** |
| **Noncurrent liabilities** | | | |
| Long–term borrowings | **18** | 725,943 | 513,219 |
| Long–term finance lease obligations | **19** | 867,626 | 1,064,534 |
| Pension Liabilities | **22** | 376,405 | 231,000 |
| Long–term income tax payable | | 1,297 | 1,899 |
| Long–term other taxes payable | **21** | 3,721 | 6,428 |
| Deferred revenue | | 124,233 | 119,294 |
| Deferred income tax liability | **28** | 840,546 | 809,022 |
| **Total noncurrent liabilities** | | **2,939,771** | **2,745,396** |
| **Current liabilities** | | | |
| Accounts payable, accrued expenses and advances received | **20** | 1,390,968 | 1,462,204 |
| Payables to Rostelecom | | 85,106 | 82,167 |
| Income tax payable | | 46,533 | 164 |
| Other taxes payable | **21** | 378,945 | 329,852 |
| Dividends payable | | 15,819 | 12,047 |
| Short–term borrowings | **18** | 338,596 | 120,373 |
| Current portion of long–term borrowings | **18** | 1,726,362 | 1,238,521 |
| Current portion of long–term finance lease obligations | **19** | 349,791 | 343,262 |
| Provisions | | | 16,000 |
| **Total current liabilities** | | **4,332,120** | **3,604,590** |
| **Total liabilities** | | **7,271,891** | **6,349,986** |
| **TOTAL EQUITY AND LIABILITIES** | | **14,128,326** | **12,967,733** |

*The accompanying notes form an integral part of these consolidated financial statements.*

# OJSC Far East Telecommunications Company

## Consolidated Statement of Operations

## for the year ended December 31, 2005

*(in thousands roubles, except per share amounts)*

| | Notes | 2005 | 2004 as restated |
|---|---|---|---|
| **Revenues** | **23** | **10,696,372** | **8,933,554** |
| Wages, salaries, other benefits and payroll taxes | | (4,355,302) | (3,742,273) |
| Depreciation and amortization | **5,6** | (1,046,085) | (915,289) |
| Materials, repairs and maintenance, utilities | | (928,591) | (871,787) |
| Taxes other than income tax | | (190,411) | (144,943) |
| Interconnection charges | | (1,815,902) | (1,611,463) |
| Recovery of (provision for) impairment of receivables | **13** | 89,712 | (121,633) |
| Loss on disposal of property, plant and equipment | | (70,135) | (25,163) |
| Other operating expenses, net | **24** | (1,020,190) | (927,476) |
| **Operating profit** | | **1,359,468** | **573,527** |
| Share of result of associates | **8** | (334) | 232,843 |
| Gain on sale of subsidiaries, associates and other investments | **26** | 218,748 | 573,546 |
| Other gain (loss) from investments, net | **27** | (12,341) | 10,669 |
| Interest expense, net | **25** | (461,135) | (283,338) |
| Foreign exchange gain (loss), net | | (5,332) | 7,070 |
| **Profit before income tax** | | **1,099,074** | **1,114,317** |
| **Income tax expense** | **28** | **(487,617)** | **(430,430)** |
| **Profit for the year** | | **611,457** | **683,887** |
| Attributable to: | | | |
| Equity holders of the parent | | 613,035 | 683,887 |
| Minority interests | | (1,578) | – |
| **Earnings per share** | | | |
| - basic and diluted, for profit for the year attributable to equity holders of the parent (Russian Roubles) | **29** | **4.837** | **5.396** |

*The accompanying notes form an integral part of these consolidated financial statements.*

# OJSC Far East Telecommunications Company

## Consolidated Statement of Cash Flows

## for the year ended December 31, 2005

*(in thousands roubles)*

| | Notes | 2005 | 2004 |
|---|---|---|---|
| **Cash flows from operating activities:** | | | |
| Profit before income tax and minority interest | | 1,099,074 | 1,114,317 |
| **Adjustments for:** | | | |
| Depreciation and amortization | 5,6 | 1,046,085 | 915,289 |
| (Recovery of) / Provision for impairment of receivables | 13 | (89,712) | 121,633 |
| Provision for legal claim | | – | 16,000 |
| Loss on disposal of property, plant, and equipment | | 70,135 | 25,163 |
| Share of result of associates | 8 | 334 | (232,843) |
| Gain on sale of subsidiary, associates and other investments | 26 | (218,748) | (573,546) |
| Interest expense, net | 25 | 461,135 | 283,338 |
| Foreign exchange loss (gain), net | | 5,332 | (7,070) |
| Other loss (gain) from investments, net | | 12,341 | (10,669) |
| Other | | – | 27,820 |
| **Operating cash flows before working capital changes** | | **2,385,976** | **1,679,432** |
| Increase in accounts receivable | | (103,888) | (283,625) |
| Decrease (increase) in other current assets | | 55,035 | (227,285) |
| Decrease (increase) in inventories | | 60,304 | (184,828) |
| Increase in pension liabilities | | 145,406 | 49,000 |
| Increase in accounts payable, accrued expenses and advances received | | 211,835 | 235,094 |
| Increase in payables to Rostelecom | | 2,939 | 5,467 |
| Increase in taxes payable | | 46,385 | 37,643 |
| **Cash flows generated from operations** | | **2,803,992** | **1,310,898** |
| Interest paid | | (222,012) | (176,683) |
| Income tax paid | | (272,854) | (586,714) |
| **Net cash flows from operating activities** | | **2,309,126** | **547,501** |
| **Cash flows from investing activities:** | | | |
| Purchase of property, plant and equipment | | (1,896,055) | (1,233,851) |
| Purchase of intangible assets | | (47,834) | (18,452) |
| Purchase of Oracle E–Business Suite | | (79,632) | (65,251) |
| Purchase of Amdocs Billing Suite | | (187,944) | – |
| Acquisition of subsidiaries and other investments, net of cash acquired of 3,786 | | (279,579) | – |
| Proceeds from sales of property, plant and equipment | | 18,737 | 1,045 |
| Proceeds from sale of subsidiary, net of cash disposed in amount of 37 | | – | 3,275 |
| Proceeds from sale of associates and other financial assets | | 222,910 | 1,156,020 |
| Loans given to employees and repayment received, net | | (4,818) | (21,891) |
| Interest received | | 4,512 | 1,721 |
| Dividends received | | 268 | 10,700 |
| **Net cash flows used in investing activities** | | **(2,249,435)** | **(166,684)** |
| **Cash flows from financing activities:** | | | |
| Proceeds from promissory notes issues | | 356,000 | 148,000 |
| Repayment of promissory notes | | (64,000) | (234,706) |
| Proceeds from borrowings | | 1,398,247 | 1,040,308 |
| Repayment of borrowings | | (699,474) | (705,308) |
| Repayment of finance lease obligations | | (815,723) | (530,748) |
| Repayment of vendor financing obligations | | (10,000) | (46,470) |
| Repayment of other non–current liabilities | | 2,436 | (8,936) |
| Dividends paid | | (198,056) | (53,857) |
| **Net cash flows (used in) financing activities** | | **(30,570)** | (391,717) |
| **Net increase (decrease) in cash and cash equivalents** | | **29,121** | (10,900) |
| **Cash and cash equivalents at the beginning of the year** | | **129,210** | 140,110 |
| **Cash and cash equivalents at the end of the year** | | **158,331** | 129,210 |

*The accompanying notes form an integral part of these consolidated financial statements.*

# OJSC Far East Telecommunications Company

## Consolidated Statement of Changes in Equity

## for the year ended December 31, 2005

*(in thousands roubles)*

| | Notes | Attributable to equity holders of the parent | | | | | Minority interests | Total equity |
|---|---|---|---|---|---|---|---|---|
| | | Share capital | | | Unrealized gain/(loss) on available–for–sale investments | Total | | |
| | | Preference shares | Ordinary shares | Retained earnings | | | | |
| **Balance at December 31, 2003** | | **769,364** | **2,328,839** | **2,737,814** | **2,381** | **5,838,398** | **–** | **5,838,398** |
| Profit for the year, as restated | | – | – | 683,887 | – | 683,887 | – | 683,887 |
| Dividends to equity holders of parent | | – | – | (60,986) | – | (60,986) | – | (60,986) |
| Unrealized gain/(loss) on available–for–sale investments | | – | – | – | 156,448 | 156,448 | | 156,448 |
| Increase of nominal value of shares | | 311,689 | 955,814 | (1,267,503) | – | – | – | – |
| **Balance at December 31, 2004, as restated** | | **1,081,053** | **3,284,653** | **2,093,212** | **158,829** | **6,617,747** | – | **6,617,747** |
| Profit for the year | | – | – | 613,035 | – | 613,035 | (1,578) | 611,457 |
| Dividends to equity holders of parent | 30 | – | – | (227,217) | – | (227,217) | – | (227,217) |
| Unrealized gain/(loss) on available–for–sale investments | | – | – | – | (158,829) | (158,829) | – | (158,829) |
| Minority interests arising on acquisition of subsidiary | | – | – | – | – | – | 13,277 | 13,277 |
| **Balance at December 31, 2005** | | **1,081,053** | **3,284,653** | **2,479,030** | **–** | **6,844,736** | **11,699** | **6,856,435** |

*The accompanying notes form an integral part of these consolidated financial statements.*

## 1. General Information

### Authorization of Accounts

The consolidated financial statements of OJSC Far East Telecommunications Company and its subsidiaries – (hereinafter "the Company") for the year ended December 31, 2005 were authorized for issue by the General Director and the Chief Accountant of the Company on June 16, 2006.

### The Company

The Company is an open joint stock company incorporated in accordance with the laws of the Russian Federation.

The registered office of the Company is located in Vladivostok (the Russian Federation), Svetlanskaya str. 57.

The Company's principal activity is providing telephone services (including local, domestic long-distance and international long-distance calls), telegraph and data transmission services, rent of communication channels and wireless communication services on the territory of the Far East region of the Russian Federation.

Open joint-stock company Svyazinvest, controlled by the Russian Government, as a holding company, owned 51% of the Company's ordinary voting stock as of December 31, 2005.

Information of the Company's main subsidiaries is disclosed in Note 7. All subsidiaries are incorporated under the laws of the Russian Federation.

### Presentation of Financial Statements

Consolidated financial statements of the Company are prepared on the basis of standalone financial statements of the parent and its subsidiaries and associates prepared under unified accounting policies.

The measurement and presentation currency of the Company is Russian Rouble, which is the national currency of the Russian Federation.

Consolidated financial statements of the Company are presented in thousands of Russian Roubles.

### Tariff Setting

Tariffs relating to intercity traffic are regulated by the government and tariffs for international traffic are regulated by OJSC "Rostelecom" which is controlled by OJSC "Svyazinvest" holding.

In 2005 the Company revised its tariffs for telephone services with the aim to decrease the effect of cross-subsidization between domestic long-distance and local services by changing the tariffs for local telephone calls.

In general, the Company increased tariffs in 2005 and 2004 as follows:

| Customer groups | Urban areas | | Rural areas | |
|---|---|---|---|---|
| | 2005 | 2004 | 2005 | 2004 |
| Residential | 16.8% | 28.2% | 17.4% | 28.2% |
| Corporate | 13.3% | 22.3% | 12.6% | 22.3% |

## 1. General Information (continued)

### Tariff Setting (continued)

New regulations supporting the implementation of the Federal Law on Communications are effective from January 1, 2006. These regulations affect the principles of provision of fixed line telecommunication services and change licensing requirements to the Company (see also Note 35 on tariffs for telecommunication services).

### Liquidity and Financial Resources

As of December 31, 2005, the Company's current liabilities exceeded its current assets by 2,401,034 (December 31, 2004 – 1,506,889). As a result, there may be some doubts about the Company's ability to attract further financing and to pay its existing debts as they fall due.

To date, the Company has significantly relied upon short-term and long-term financing to fund the improvement of its telecommunication network. This financing has historically been provided through bank loans, bonds, vendor financing, and finance leases.

If needed, management believes that certain projects may be deferred or curtailed in order to fund the Company's current operating needs. Management also expects to be able to delay payment for certain operating costs to manage its working capital requirements if necessary.

Through 2006 the Company anticipates funding from a) cash generated from operations; b) bonds placement in the domestic market; c) lease agreements; d) financing from domestic and international lending institutions.

## 2. Basis of Presentation of the Financial Statements

### Basis of Preparation

These consolidated financial statements have been prepared and presented in accordance with International Financial Reporting Standards ("IFRS").

These consolidated financial statements have been prepared based on the statutory financial statements in accordance with the Regulations on Accounting and Reporting of the Russian Federation, with adjustments and reclassifications recorded for the purpose of fair presentation of ending balances, results of operations and cash flows in accordance with IFRS.

These financial statements have been presented on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. Accordingly, the financial statements do not include any adjustments related to the recoverability and classification of recorded asset amounts or any other adjustments that might result if the Company either be unable to continue as a going concern or if the Company was to dispose of assets outside the normal course of its operating plan.

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

The Company transitioned to IFRS as of January 1, 2003 using the provisions of IFRS 1, "First-time Adoption of International Financial Reporting Standards", which is effective for periods starting on or after January 1, 2003. IFRS 1 applies to first-time adopters of IFRS including companies that previously applied some, but not all IFRS, and disclosed this fact in its most recent previous financial statements.

## 2. Basis of Presentation of the Financial Statements (continued)

### Basis of Preparation (continued)

The Company has applied an exemption permitted by IFRS 1 which allows an entity to measure property, plant, and equipment at the date of transition to IFRS at fair value and use that fair value as deemed cost. The Company has also applied the exemption permitted by IFRS 1 which allows an entity to recognize all cumulative actuarial gains and losses at the date of transition even if the corridor approach is used for latter actuarial gains and losses.

Management estimates that the carrying value of all of the Company's property, plant and equipment is broadly comparable to their fair values. However, management intends to engage an independent appraiser to support these fair values and as a result, the reported carrying amount of property, plant and equipment may be adjusted. It is expected that the appraisal will be completed in the near future.

The Russian economy was considered hyperinflationary until prior to January 1, 2003. As such, the Company applied IAS 29 "Financial Reporting in Hyperinflationary Economies" by restating non-monetary items, including components of equity (except for the property, plant and equipment, for which fair values as at January 1, 2003 have been used as deemed cost) to the measuring units current at January 1, 2003 by applying the relevant inflation indices to the historical cost. These restated values were used as a basis for accounting in subsequent periods.

The accounting policies adopted are consistent with those of the previous financial year except that the Company has adopted those new/revised standards mandatory for financial years beginning on or after January 1, 2005.

The changes in accounting policies result from adoption of the following new or revised standards:

- IFRS 2 "Share-Based Payment";
- IFRS 5 "Noncurrent Assets Held for Sale and Discontinued Operations";
- IAS 1 (revised) "Presentation of Financial Statements";
- IAS 2 (revised) "Inventories";
- IAS 8 (revised) "Accounting Policies, Changes in Accounting Estimates and Errors";
- IAS 10 (revised) "Events after the Balance Sheet Date";
- IAS 16 (revised) "Property, Plant and Equipment";
- IAS 17 (revised) "Leases";
- IAS 24 (revised) "Related Party Disclosures";
- IAS 27 (revised) "Consolidated and Separate Financial Statements";
- IAS 28 (revised) "Investments in Associates";
- IAS 31 (revised) "Interests in Joint Ventures";
- IAS 32 (revised) "Financial Instruments: Presentation and Disclosure";
- IAS 33 (revised) "Earnings per Share";
- IAS 39 (revised) "Financial Instruments: Recognition and Measurement".

The principal effects of these changes in policies are discussed below.

## 2. Basis of Presentation of the Financial Statements (continued)

### Basis of Preparation (continued)

*IAS 1 (revised) "Presentation of Financial Statements" and IAS 27 "Consolidated and Separate Financial Statements"*

Minority interests in the net assets of the Company's subsidiaries are presented within equity, separately from parent shareholders' equity. Previously, minority interests were presented separately from liabilities and equity in the Company's consolidated balance sheet.

*IAS 39 "Financial Instruments: Recognition and Measurement" (amended 2004)*

The gains and losses on re-measurement of financial assets available-for-sale to fair value are recognized as a separate component of equity. A gain or loss on an available-for-sale financial asset is recognized directly in equity, except for impairment losses and foreign exchange gains and losses, until the financial asset is derecognized, at which time the cumulative gain or loss previously recognized in equity is recognized in profit or loss. However, interest calculated using the effective interest method is recognized in profit or loss. Dividends on an available-for-sale equity instrument are recognized in profit or loss when the Company's right to receive payment is established.

*IFRSs and IFRIC Interpretations not yet effective*

The Company has not applied the following IFRSs and IFRIC Interpretations that have been issued but are not yet effective:

- IAS 19 (amended 2004) "Employee Benefits";
- IAS 39 (amended 2005) "Financial Instruments: Recognition and Measurement";
- IFRS 6 "Exploration for and Evaluation of Mineral Resources";
- IFRS 7 "Financial Instruments: Disclosures";
- IFRIC 4 "Determining whether an Arrangement contains a Lease";
- IFRIC 5 "Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds".

The Company expects that the adoption of the pronouncements listed above will have no significant impact on the Company's financial statements in the period of initial application.

### Management Estimates

The preparation of financial statements requires management of the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

## 2. Basis of Presentation of the Financial Statements (continued)

### Management Estimates (continued)

The most significant estimates with regard to those financial statements relate to the valuation and useful lives of property, plant and equipment and intangible assets as discussed in Notes 5, 6. The determination of impairments of property, plant and equipment involves the use of estimates that include, but are not limited to, the cause, timing and amount of the impairment. Impairment is based on a large number of factors, such as changes in current competitive conditions, expectations of growth in the telecommunication industry, increased cost of capital, changes in the future availability of financing, technological obsolescence, discontinuance of service, current replacement costs and other changes in circumstances that indicate an impairment exists. The recoverable amount and the fair values are typically determined using a discounted cash flow method which incorporates reasonable market participant assumptions. The identification of impairment indicators, the estimation of future cash flows and the determination of fair values for assets (or group of assets) requires management to make significant judgments concerning the identification and validation of impairment indicators, expected cash flows, applicable discount rates, useful lives and residual values. Specifically, the estimation of cash flows underlying the value in use of the Company's property, plant and equipment considers the impact of the new rules and regulations under new provisions of the Federal Law on Communications as discussed in detail in Note 35. As part of this reform, a new price-setting and settlements mechanism among the telecom operators was introduced. Some elements of this mechanism remain unclear and may be subject to additional clarification from the regulators. If this mechanism is changed, this may significantly affect the management's estimates of the future cash flows and operating results and, consequently, the amount of potential impairment of the Company's property, plant and equipment.

The determination of the recoverable amount of a cash-generating unit involves the use of estimates by management. Methods used to determine the value in use include discounted cash flow-based methods and methods that use quoted stock market prices as a basis. These estimates, including the methodologies used, can have a material impact on the fair value and ultimately the amount of any property, plant and equipment impairment.

The management also made significant estimates with regard to those financial statements relate to deferred taxation, provision for bad debt reserve and pension liabilities as discussed in Notes 28, 13 and 22.

### Estimation Uncertainty

The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

*Impairment of Goodwill and Intangible Assets*

The Company determines whether goodwill and intangible assets not yet available for use are impaired at least on an annual basis. This requires an estimation of the value in use of the cash-generating units to which the goodwill and intangible assets referred to above are allocated. Estimating the value in use requires the Company to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows. The Company did not have the goodwill as of December 31, 2004. As at December 31, 2005 the Company recognized an impairment loss of 76,699 on goodwill acquired in 2005 through business combinations, so that the carrying amount of the goodwill was reduced to nil. The carrying amount of intangible assets not yet available for use at December 31, 2005 was 597,858 (2004: 503,517). Refer further to Note 6.

*(in thousands roubles)*

## 2. Basis of Presentation of the Financial Statements (continued)

### Correction of Errors and Reclassifications

The Company revised valuation of the tax base of certain assets and liabilities and made adjustment to the amount of deferred income tax liability as of December 31, 2004.

| | As previously reported | Effect of adjustments | As restated | Description of adjustments |
|---|---|---|---|---|
| **Consolidated balance sheet as at December 31, 2004** | | | | |
| Deferred income tax liabilities | 736,842 | 72,180 | 809,022 | Effect of reassessment of tax base of certain assets and liabilities |
| Retained earnings | 2,165,392 | (72,180) | 2,093,212 | |
| **Consolidated statement of operations for 2004** | | | | |
| Income tax expense | (358,250) | (72,180) | (430,430) | Effect of reassessment of tax base of certain assets and liabilities |

In addition the Company made the following reclassifications to the 2004 financial statements to conform to the 2005 presentation:

| | As previously reported | Effect of reclassifications | As restated | Description of reclassifications |
|---|---|---|---|---|
| **Consolidated balance sheet as at December 31, 2004** | | | | |
| Current income tax asset | – | 126,249 | 126,249 | Current income tax assets was reclassified to the separate line from Other current assets |
| Other current assets, net | 676,457 | (126,249) | 550,208 | |
| Long–term income tax payable | – | 1,899 | 1,899 | Long–term income tax payable was reclassified to the separate line from Long–term taxes payable |
| Long–term other taxes payable | 8,327 | (1,899) | 6,428 | |
| Income tax payable | – | 164 | 164 | Current income tax payable was reclassified to the separate line from Other taxes payable |
| Other taxes payable | 330,016 | (164) | 329,852 | |
| Deferred revenue | 100,554 | 18,740 | 119,294 | Deferred revenue was reclassified from other non–current liabilities |
| Other non–current liabilities | 18,740 | (18,740) | – | |
| **Consolidated Income statement for 2004** | | | | |
| Wages, salaries, other benefits and payroll taxes | 3,776,030 | (33,757) | 3,742,273 | Compensations for Revision committee and BOD members was reclassified to Other operating expenses, net |
| Other operating expenses, net | 893,719 | 33,757 | 927,476 | |

## 3. Summary of Significant Accounting Policies

### 3.1 Principles of Consolidation

The consolidated financial statements of the Company represent the financial statements of the Group of companies, i.e. the parent and its subsidiaries, presented as if the Company operated as a single economic entity.

*Subsidiaries*

Subsidiaries, which are those entities in which the Company has an interest of more than one half of the voting rights, or otherwise has power to exercise control over their operations, are consolidated. The Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Subsidiaries are consolidated from the date on which control is transferred to the Company and are no longer consolidated from the date that control ceases. All intercompany transactions, balances and unrealized gains on transactions between parent Company and/or subsidiaries are eliminated; unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. In case of necessity, accounting policies for subsidiaries have been changed to ensure consistency with the policies adopted by the Company.

*Acquisition of Subsidiaries*

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Company. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest.

The excess of purchase consideration over the fair value of the Company's share of identifiable net assets is recorded as goodwill. If the cost of the acquisition is less than the fair value of the Company's share of identifiable net assets of the subsidiary acquired the difference is recognized directly in the statement of operations.

Minority interest is the interest in subsidiaries not held by the Company. Minority interest at the balance sheet date represents the minority shareholders' portion of the fair value of the identifiable assets and liabilities of the subsidiary at the acquisition date and the minorities' portion of movements in equity since the date of the combination. Minority interest is presented within the shareholders' equity.

Losses allocated to minority interest do not exceed the minority interest in the equity of the subsidiary unless there is a binding obligation of the minority to fund the losses. All such losses are allocated to the Company.

*Acquisition of Minority Interest in Subsidiaries*

The difference between the cost of the additional interest in a subsidiary and the minority interest's share of the assets and liabilities is reflected in the consolidated statement of shareholders' equity at the date of the purchase of the minority interest as a charge to retained earnings. The Company does not remeasure the assets and liabilities of the subsidiary to reflect their fair values at the date of the transaction.

### 3.2 Investments in Associates

Associates are entities in which the Company generally has between 20% and 50% of the voting rights, or is otherwise able to exercise significant influence, but which it does not control or jointly control. Investments in associates are accounted for under the equity method and are initially recognized at cost, including goodwill. Subsequent changes in the carrying value reflect the post-acquisition changes in the Company's share of net assets of the associate. The Company's share of its associates' profits or losses is recognized in the statement of operations, and its share of movements in reserves is recognized in equity. However, when the Company's share of losses in an associate equals or exceeds its interest in the associate, the Company does not recognize further losses, unless the Company is obliged to make further payments to, or on behalf of, the associate.

## 3. Summary of Significant Accounting Policies (continued)

### 3.2 Investments in Associates (continued)

Unrealized gains on transactions between the Company and its associates are eliminated to the extent of the Company's interest in the associates; unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

### 3.3 Investments

The Company's investments are classified as either loans and receivables, available-for-sale investments or financial assets at fair value through profit or loss, as appropriate. When investments are recognized initially, they are measured at fair value plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs.

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held-to-maturity when the Company has the positive intention and ability to hold to maturity. During the period the Company did not hold any investments in this category.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than:

(a) those that the entity intends to sell immediately or in the near term, which shall be classified as held for trading, and those that the entity upon initial recognition designates as at fair value through profit or loss;
(b) those that the entity upon initial recognition designates as available for sale; or
(c) those for which the holder may not recover substantially all of its initial investment, other than because of credit deterioration, which shall be classified as available for sale.

Such assets are carried at amortized cost using the effective interest method. Gains and losses are recognized in income when the loans and receivables are derecognized or impaired, as well as through the amortization process.

Available-for-sale investments are those non-derivative financial assets that are designated as available-for-sale or are not classified as held-to-maturity, loans and receivables or investments at fair value through profit or loss. After initial recognition available-for-sale investments are measured at fair value with gains or losses being recognized as a separate component of equity until the investment is derecognized or until the investment is determined to be impaired, at which time the cumulative gain or loss previously reported in equity is included in the statement of operations. Reversals of impairment losses in respect of equity instruments are not recognized in the statement of operations. Impairment losses in respect of debt instruments are reversed through profit or loss if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss was recognized in the statement of operations.

The fair value of investments that are actively traded in organized financial markets is determined by reference to the quoted market bid prices at the close of business on the balance sheet date. For investments where there is no active market, fair value is determined using valuation techniques. Such techniques include using recent arm's length market transactions; reference to the current market value of another instrument, which is substantially the same and discounted cash flow analysis.

## 3. Summary of Significant Accounting Policies (continued)

### 3.4 Accounting Policies, Changes in Accounting Estimates and Errors

*Change in Accounting Policies*

The Company changes an accounting policy only if the change is required by a Standard or an Interpretation of IFRS or results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the Company's financial position, financial performance or cash flows.

The Company accounts for a change in accounting policy resulting from the initial application of a Standard or an Interpretation in accordance with the specific transitional provisions, if any, in that Standard or Interpretation.

*Changes in Accounting Estimates*

As a result of the uncertainties inherent in business activities, many items in financial statements cannot be measured with precision but can only be estimated. Estimation involves judgments based on the latest available, reliable information. An estimate may need revision if changes occur in the circumstances on which the estimate was based or as a result of new information or more experience.

When it is difficult to distinguish a change in an accounting policy from a change in an accounting estimate, the change is treated as a change in an accounting estimate. The effect of a change in an accounting estimate is recognized prospectively by including it in profit or loss in the period of the change, if the change affects that period only or the period of the change and future periods, if the change affects both.

*Prior Period Errors*

The Company corrects material prior period errors retrospectively in the first set of financial statements authorized for issue after their discovery by restating the comparative amounts for the prior period presented in which the error occurred or if the error occurred before the earliest prior period presented, by restating the opening balances of assets, liabilities and equity for the earliest prior period presented.

Prior period error is corrected by retrospective restatement except to the extent that it is impracticable to determine either the period-specific effects or the cumulative effect of the error.

### 3.5 Foreign Currency Transactions

The measurement and presentation currency of the Company is the Russian Rouble, which is the national currency of the Russian Federation. Transactions in foreign currencies are initially recorded in the measurement currency at the rate ruling at the date of transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the measurement currency rate of exchange ruling at the balance sheet date. All resulting differences are taken to the consolidated statement of operations as foreign exchange gains (losses). Nonmonetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate as at the date of initial transaction.

Assets and liabilities settled in Roubles but denominated in foreign currencies are recorded in the Company's consolidated financial statements using the same principles as for assets and liabilities denominated in foreign currencies.

*(in thousands roubles)*

## 3. Summary of Significant Accounting Policies (continued)

### 3.5 Foreign Currency Transactions (continued)

The exchange rates as of December, 31 2005 and 2004 were as follows:

| Currency | 2005 | 2004 |
|---|---|---|
| Russian Roubles per US dollar | 28.78 | 27.75 |
| Russian Roubles per Euro | 34.19 | 37.81 |
| Russian Roubles per Japanese yen | 0.25 | 0.27 |

### 3.6. Property, Plant and Equipment

Property, plant and equipment are recorded at purchase or construction cost less accumulated depreciation and any impairment in value. For the property, plant and equipment acquired prior to January 1, 2003, fair values as at January 1, 2003 have been used as deemed cost (refer to Note 2) in accordance with the exemption provided in IFRS 1. The carrying values of property, plant and equipment are reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. If any such indication exists and where the carrying values exceed the estimated recoverable amount, the assets or cash-generating units are written down to their recoverable amount. The recoverable amount of property, plant and equipment is the greater of net selling price and value in use. Impairment losses are recognized in the statement of operations.

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

Expenditure for continuing repairs and maintenance are charged to the statement of income as incurred. Social assets are expensed on acquisition. Major renewals and improvements are capitalized, and the assets replaced are retired.

### 3.6.1 Depreciation and Useful Life

Depreciation is calculated on property, plant and equipment on a straight-line basis from the time the assets are available for use, over their estimated useful lives as follows:

| | |
|---|---|
| Buildings and Constructions | 20-50 years |
| Analog switches | 10-20 years |
| Digital switches | 10-15 years |
| Other telecommunication equipment | 10-20 years |
| Transportation equipment | 5 years |
| Computers, office and other equipment | 3-5 years |
| Land | not depreciated |

The asset's residual values, useful lives and methods are reviewed, and adjusted as appropriate, at each financial year-end.

## 3. Summary of Significant Accounting Policies (continued)

### 3.6. Property, Plant and Equipment (continued)

#### 3.6.1 Depreciation and Useful Life (continued)

Depreciation of an asset begins when it is available for use, i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by the management. Depreciation of an asset ceases at the earlier of the date that the asset is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with IFRS 5 “Non-current Assets Held for Sale and Discontinued Operations” and the date that the asset is derecognized.

The depreciation charge for a period is usually recognized in profit or loss. However, sometimes, the future economic benefits embodied in an asset are absorbed in producing other assets. In this case, the depreciation charge constitutes part of the cost of the other asset and is included in its carrying amount.

The period of validity of the Company’s operating licenses is significantly shorter than the useful lives used for depreciation of the cost of property, plant and equipment. Based on the Russian licensing legislation and prior experience, management believes that the operating licenses will be renewed without significant cost, which would allow the Company to realize the cost of its property, plant and equipment through normal operations.

#### 3.6.2 Construction in Progress

Construction in progress is recorded as the total of actual expenditures incurred by the Company from the beginning of construction to the reporting date less any impairment in value.

#### 3.6.3 Assets Received Free of Charge

Equipment transferred to the Company free of charge by its customers and other entities outside the privatization process is capitalized at market value at the date of transfer. A corresponding income is fully recognized in the statement of operations. In cases transfers of equipment relate to the rendering of future services to the transferee the equipment is considered a deferred revenue and is recognized into income on the same basis that the equipment is depreciated.

Equipment contributions that do not generate any future income for the Company are not recognized.

### 3.7 Intangible Assets

#### 3.7.1 Goodwill

Goodwill represents the excess of the cost of an acquisition over the net fair value of the Company’s share of the identifiable assets, liabilities and contingent liabilities of the acquired subsidiary or associate at the date of acquisition. Goodwill on an acquisition of a subsidiary is included in intangible assets. Goodwill on an acquisition of an associate is included in the investments in associates. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses.

Goodwill is reviewed for impairment, annually or more frequently if events or changes in circumstances indicate that the carrying amount may be impaired. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Company’s cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the Company are assigned to those units or groups of units. Each unit or group of units to which the goodwill is so allocated:

**3. Summary of Significant Accounting Policies (continued)**

**3.7 Intangible Assets (continued)**

**3.7.1 Goodwill (continued)**

- Represents the lowest level within the Company at which the goodwill is monitored for internal management purposes; and
- Is not larger than a segment based on either the Company's primary or the Company's secondary reporting format determined in accordance with IAS 14 "Segment Reporting".

Impairment is determined by assessing the recoverable amount of the cash-generating unit (group of cash-generating units), to which the goodwill relates. Where the recoverable amount of the cash-generating unit (group of cash-generating units) is less than the carrying amount, an impairment loss is recognized. Where goodwill forms part of a cash-generating unit (group of cash-generating units) and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained.

An impairment loss recognized for goodwill is not reversed in subsequent periods.

The excess of the net fair value of the Company's share of the identifiable assets, liabilities and contingent liabilities of the acquired subsidiary or associate at the date of acquisition over the cost of an acquisition is recognized in profit or loss.

**3.7.2 Licenses**

Cost of licenses paid to the Government for permission to provide telecommunication services is recognized as intangible assets. The licenses are recorded at purchase cost less accumulated depreciation and any impairment in value.

**3.7.3 Software and Other Intangible Assets**

Software and other intangible assets acquired separately are measured on initial recognition at cost. The cost of other intangible assets acquired in a business combination is their fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses.

**3.7.4 Useful Life and Amortization of Intangible Assets**

The Company assesses whether the useful life of an intangible asset is finite or indefinite and, if finite, the length of, or number of production or similar units constituting, that useful life. An intangible asset is regarded by the entity as having an indefinite useful life when, based on an analysis of all of the relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity.

Intangible assets with finite lives are amortized over the useful economic lives and assessed for impairment whenever there is an indication that the intangible asset may be impaired.

The cost of licenses and software is amortized on a straight-line basis over the estimated useful life equal to the term of the licenses or the right to use the software.

Useful life of other intangible assets is approximately 10 years.

## 3. Summary of Significant Accounting Policies (continued)

### 3.7 Intangible Assets (continued)

#### 3.7.4 Useful Life and Amortization of Intangible Assets (continued)

Amortization periods and methods for intangible assets with finite useful lives are reviewed at least at each financial year-end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset is accounted for by changing the amortization period or method, as appropriate, and treated as changes in accounting estimates.

Intangible assets with indefinite useful lives are not amortized, but tested for impairment annually either individually or at the cash-generating unit level. The useful life of an intangible asset with an indefinite life is reviewed annually to determine whether indefinite life assessment continues to be supportable. If not, the change in the useful life assessment from indefinite to finite is made on a prospective basis.

### 3.8 Borrowing Costs

The borrowing costs are capitalized by the Company as part of the cost of the asset when it is probable that they will result in future economic benefits to the entity and the costs are directly attributable to the acquisition, construction or production of a qualifying asset including construction in progress.

To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization on that asset is determined as the actual borrowing costs incurred on that borrowing during the period.

To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization is determined by applying a capitalization rate to the expenditures on that asset. The capitalization rate is the weighted average of the borrowing costs applicable to the borrowings of the entity that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. The amount of borrowing costs capitalized during a period shall not exceed the amount of borrowing costs incurred during that period.

### 3.9 Leases

Leases where all the risks and rewards of ownership of the asset are transferred from the lessor to the leasee are classified as finance leases.

Leases where the lessor retains substantially all the risks and rewards of the ownership of the asset are classified as operating leases.

#### 3.9.1 Finance Leases

At the commencement of the lease term, or the date from which the lessee is entitled to exercise its right to use the leased asset, the Company recognizes finance leases as assets and liabilities in the balance sheet at amounts equal to the fair value of the leased property or, if lower, the present value of the minimum lease payments, each determined at the inception of the lease. At the commencement of the lease term, the asset and the liability for the future lease payments are recognized in the balance sheet at the same amounts except for any initial direct costs of the lessee that are added to the amount recognized as an asset.

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

## 3. Summary of Significant Accounting Policies (continued)

### 3.9 Leases (continued)

#### 3.9.1 Finance Leases (continued)

The depreciation policy for depreciable leased assets is consistent with that for depreciable assets that are owned, and the depreciation recognized is calculated in accordance with the accounting policy of the Company applicable for depreciable and amortized assets. If there is no reasonable certainty that the lessee will obtain ownership by the end of the lease term, the asset is fully depreciated over the shorter of the lease term and its useful life.

#### 3.9.2 Operating Leases

Operating lease payments are recognized as an expense in the statement of operations on a straight-line basis over the lease term.

### 3.10 Inventories

Inventories are recorded at the lower of cost and net realizable value. Cost of inventory is determined on the weighted average basis. Net realizable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and the estimated costs necessary to make the sale.

The cost of inventories comprises all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

### 3.11 Advances Given

Advances given to acquire noncurrent assets are classified as noncurrent and considered nonmonetary asset. Long-term advances given for operating activities are also classified as noncurrent assets.

### 3.12 Financial Instruments

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

Financial assets comprise cash and cash equivalents; an equity instrument of another entity; a contractual right to receive cash or another financial asset from another entity, or to exchange financial assets or financial liabilities with another entity under conditions that are potentially favorable to the Company; or a contract that will or may be settled in the Company's own equity instruments and is a non-derivative for which the Company is or may be obliged to receive a variable number of the Company's own equity instruments, or a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the Company's own equity instruments. For this purpose the Company's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the Company's own equity instruments.

Financial liabilities include contractual obligations to deliver cash or another financial asset to another entity or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the Company; or a contract that will or may be settled in the Company's own equity instruments and is a non-derivative for which the Company is or may be obliged to deliver a variable number of the Company's own equity instruments or a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the Company's own equity instruments. For this purpose the Company's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.

## 3. Summary of Significant Accounting Policies (continued)

### 3.12 Financial Instruments (continued)

The Company recognizes a financial asset or a financial liability on its balance sheet when, and only when, the entity becomes a party to the contractual provisions of the instrument.

When a financial asset or financial liability is recognized initially, the Company measures it at its fair value plus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.

The Company classifies its financial assets and financial liabilities as current or noncurrent based on term of its maturity taking into account other factors that limit the Company's ability to realize assets within 12 months or existence of call options in financial liabilities valid within 12 months after the balance sheet date.

Financial asset is derecognised when the rights to receive cash flows from the asset expired or the Company transferred its rights to receive cash flows from the asset.

Financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

### 3.13 Cash and Cash Equivalents

Cash and cash equivalents represent cash on hand and in the Company's bank accounts, as well as cash deposits and short-term investments with original maturities of three months or less.

### 3.14 Accounts Receivable and Provision for Impairment of Receivables

Trade receivables are recognized at original invoice amount less an allowance for any uncollectible amounts. Allowance is made when there is objective evidence that the Company will not be able to collect the debts.

Provision for uncollectible amounts is created based on the historical pattern of collections of accounts receivable and specific analysis of recoverability of significant accounts.

Provision for uncollectible amounts is also created for other accounts receivable except advances given based on Company's ability to collect the debts.

Provision for impairment is recognized in the consolidated statement of operations.

The carrying amount of current trade and other receivables is a reasonable approximation of their fair value.

The fair value of non-current trade and other receivables is calculated using the effective interest method.

### 3.15 Noncurrent Assets Held for Sale and Discontinued Operations

A discontinued operation is a component of the Company that either has been disposed of, or is classified as held for sale, and represents a separate major line of business or geographical area of operations, is part of a single co-coordinated plan to dispose of a separate major line of business or geographical area of operations or is a subsidiary acquired exclusively with a view to resale.

The Company classifies a noncurrent asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use.

## 3. Summary of Significant Accounting Policies (continued)

### 3.15 Noncurrent Assets Held for Sale and Discontinued Operations (continued)

The Company measures a noncurrent asset (or disposal group) classified as held for sale at the lower of its carrying amount and fair value less costs to sell.

Immediately before the initial classification of the asset (or disposal group) as held for sale, the carrying amounts of the asset (or all the assets and liabilities in the group) are be measured in accordance with applicable IFRSs.

The Company presents and discloses information that enables users of the financial statements to evaluate the financial effects of discontinued operations and disposals of noncurrent assets (or disposal groups).

### 3.16 Troubled Debt Restructurings

A troubled debt restructuring occurs when the Company grants a concession to the debtor in the forms of modification of the terms of the debt, including the extension of the maturity date, change of payment schedule or reduction of the face amount of the debt, or in the form of transfer of the assets or an equity interest in the debtor in satisfaction of the debt. The Company recognized a loss in the amount of the difference between the fair value of the assets and/or equity interest received and the recorded amount of the receivable. This loss is recognized in full in the period the restructuring takes place.

### 3.17 Loans and Borrowings Received

Loans and Borrowings are initially recognized at the fair value of the consideration received less directly attributable transaction costs. After initial recognition, borrowings are measured at amortized cost using the effective interest method; any difference between the fair value of the consideration received (net of transaction costs) and the redemption amount is recognized as an adjustment to interest expense over the period of the borrowings.

### 3.18 Employee Benefits

#### 3.18.1 Unified Social Tax

Under provisions of the Russian legislation, social contributions are made through a unified social tax (“UST”) calculated by the Company by the application of a regressive rate to the annual gross remuneration of each employee. The Company allocates the UST to the three social funds (state pension fund, social and medical insurance funds).

The Company’s contributions relating to the UST are expensed in the year to which they relate.

#### 3.18.2 Current Employment Benefits

Wages and salaries paid to employees are recognized as expense in current period.

#### 3.18.3 Pensions and Other Post-Employment Benefits

Under collective bargaining agreements and internal regulations on additional pension benefits the Company also provides additional benefits for its active and retired employees by using post-employment defined benefit plans. The majority of the Company’s employees are eligible to participate under such post-employment benefit plans based upon a number of factors, including position and years of service.

## 3. Summary of Significant Accounting Policies (continued)

### 3.18 Employee Benefits (continued)

#### 3.18.3 Pensions and Other Post-Employment Benefits (continued)

The Company determines the present value of defined benefit obligation and the fair value of any plan assets on each reporting date separately for each plan. The obligations are valued by professionally qualified independent actuaries hired by the Company using the projected unit credit method. The assets of defined benefit plans are valued by professionally qualified actuaries or independent appraisers.

Actuarial gains and losses are recognized as income or expense when the net cumulative unrecognized actuarial gains and losses for each individual plan at the end of the previous reporting year exceeded 10% of the higher of the defined benefit obligation and the fair value of plan assets at that date. These gains or losses are recognized over the expected average remaining working lives of the employees participating in the plans.

Upon introduction of a new plan or improvement of an existing plan past service cost is recognized on a straight-line basis over the average period until the amended benefits become vested. To the extent that the benefits vest immediately past service costs are immediately expensed.

Gains or losses on the curtailment or settlement of pension benefit obligations are recognized when the curtailment or settlement occurs.

### 3.19 Income Taxes

Tax expense (tax income) is the aggregate amount included in the determination of profit or loss for the period in respect of current tax and deferred tax.

Current tax is the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period determined in accordance with the rules established by the taxation authorities, upon which income taxes are payable (recoverable).

Current tax liabilities (assets) for the current and prior periods are measured at the amount expected to be paid to (recovered from) the taxation authorities, using the tax rates (and tax laws) that have been enacted or substantially enacted by the balance sheet date.

Deferred tax assets and liabilities are calculated in respect of temporary differences using the liability method. Deferred income taxes are provided for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes, except where the deferred income tax arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

The measurement of deferred tax liabilities and deferred tax assets reflects the tax consequences that would follow from the manner in which the entity expects, at the balance sheet date, to recover or settle the carrying amount of its assets and liabilities.

## 3. Summary of Significant Accounting Policies (continued)

### 3.19 Income Taxes (continued)

Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates that have been enacted or substantively enacted at the balance sheet date.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries, associates and joint ventures, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

A deferred tax asset is recorded only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised. The carrying amount of deferred income tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilized. Any such previously recognized reduction is reversed to the extent that it becomes probable that sufficient taxable profit will be available.

Deferred tax assets and liabilities are not discounted.

### 3.20 Shareholders' Equity

#### 3.20.1 Share Capital

Ordinary shares and non-redeemable preference shares with discretionary dividends are both classified as equity.

#### 3.20.2 Dividends

Dividends are recognized as a liability and deducted from equity at the balance sheet date only if they are declared at a Shareholders' meeting before or on the balance sheet date. Dividends are disclosed when they are proposed before the balance sheet date or proposed or declared after the balance sheet date but before the financial statements are authorized for issue.

### 3.21 Minority Interest

Minority interest is the interest in subsidiaries not held by the Company. Minority interest at the balance sheet date represents the minority shareholders' portion of the fair values of identifiable assets and liabilities of the subsidiary at the acquisition date, and the minorities' portion of movements in net assets since the date of the combination. Minority interest is presented within equity, separately from the parent shareholders' equity.

### 3.22 Revenue Recognition

Revenue is recognized to the extent that it is probable that economic benefits will flow to the Company and the revenue can be reliably measured.

Revenue is recognized in the amount of cash or cash equivalents received in the form of cash or receivable. However, when the inflow of cash or cash equivalents is deferred, the fair value of the consideration may be less than the nominal amount of cash received or receivable. When the arrangement effectively constitutes a financing transaction, the fair value of the consideration is determined by discounting all future receipts using an effective interest rate.

## 3. Summary of Significant Accounting Policies (continued)

### 3.22 Revenue Recognition (continued)

#### 3.22.1 Revenue from Customers

The Company categorizes the revenue sources in fourteen major categories:

1. Long distance calls - domestic;
2. Long distance calls - international;
3. Local telephone calls;
4. Installation and connecting fees;
5. Documentary services;
6. Cellular services;
7. Radio and TV broadcasting;
8. Data transfer and telematic services;
9. New services;
10. Rent of telephone channels;
11. Services for national operators;
12. Other telecommunications services;
13. Other revenues.

*Long Distance Calls (domestic and international)*

Revenues from long distance services depend on time of call, duration of call, destination of call, type of service used, subscriber category and the applied rate plan. Customers of the Company use the service via installed fixed telephone, as well the service could be accessed by means of pay-phone. The Company charges long distance fees on a per-minute basis. The Company recognizes revenues related to the long distance services in the period when the services are rendered.

*Local Telephone Calls*

Revenue from the local telephone services depends on the duration of the telephone connections and subscription fee, while time driven billing scheme is applied. If fixed payment scheme is applied then revenue depends on the subscription fee only. Customers of the Company use the service via installed fixed telephone, as well the service could be accessed by means of pay-phone. The Company recognizes revenues related to the monthly network fees for local services in the month the service is provided to the subscriber.

*Installation and Connection Fees*

Installation and connection fees for indefinite period contracts are paid by a combination of a fixed cash amount and by the contribution of fixed assets consisting of cable and duct, commonly referred to as the “last mile”. Revenue received in the form of cash is recognized when the installation and connection are complete. For installation and connection fees paid in the form of fixed assets, revenue is deferred and recognized into income on the same basis that the fixed assets are depreciated.

*Documentary Services*

Revenues from telegraph services comprise fees for telegram transmissions and other wire line data transmission services. The Company recognizes revenues related to telegraph services in the period when the services are rendered.

## 3. Summary of Significant Accounting Policies (continued)

### 3.22 Revenue Recognition (continued)

#### 3.22.1 Revenue from Customers (continued)

*Cellular Services*

Major revenues from cellular services arise from airtime services including local, intercity long distance and international long distance calls, subscription fees, value added services, outbound and inbound roaming. The Company recognizes revenues related to mobile telecommunications services in the period when the services are rendered.

*Radio and TV Broadcasting*

The Company maintains a wireline radio broadcasting network. The revenues comprise monthly fees from subscribers and installation fees for wireline radio sets. The Company recognizes the revenues related to radio broadcasting in the period when the services are rendered.

*Data Transfer and Telematics Services*

The Company recognizes revenues related to data transfer and telematics services in the period when the services are rendered.

*New Services*

Major revenues from new services include internet services, ISDN, ADSL, IP-telephony, intelligent network services. The Company recognizes revenues related to new services in the period when the services are rendered.

*Rent of Telephone Channels*

Major revenues are recognized from the following services: rent of intercity and international, digital, analogue, and telegraph channels. The Company recognizes revenues from the rent of channels in the period when the services are rendered.

*Services for National Operators*

Revenue from national service providers includes two different groups.

The first group of revenues represents services rendered to the Company's partners for termination of long-distance traffic of its operators-partners in the network of the Company.

The second group of revenues from national operators represents services rendered to interconnected telecom operators that transfer local, intercity and international traffic of their customers via network of the Company.

Major revenues are recognized from the services rendered to operators for transit of local, intercity and international traffic. Further, the Company generates revenue from interconnection to the network (one time fees), rent of channels, rent of equipment, data transfer and Internet services.

The Company recognizes revenues from national operators in the period when the services are rendered.

## 3. Summary of Significant Accounting Policies (continued)

### 3.22 Revenue Recognition (continued)

#### 3.22.1 Revenue from Customers (continued)

*Other Telecommunication Services*

Other telecommunication services primarily consist of revenues received by public switched telephone network (PSTN) stations from the rent of direct lines and local junctions, as well as subscription fees for wired-radio outlets. The Company recognizes revenues related to other services in the period when the services are rendered.

*Other Revenues*

Other revenues primarily consist of revenues received from manufacturing of the telecommunication equipment and its technical support, transportation services, recreation services and sale of products and services provided by auxiliary units.

### 3.23 Barter Transactions

When goods or services are exchanged or swapped for goods or services which are of a similar nature and value, the exchange is not regarded as a transaction which generates revenue. When goods are sold or services are rendered in exchange for dissimilar goods or services, the exchange is regarded as a transaction which generates revenue. The revenue is measured at the fair value of the goods or services received, adjusted by the amount of any cash or cash equivalents transferred. When the fair value of the goods or services received cannot be measured reliably, the revenue is measured at the fair value of the goods or services given up, adjusted by the amount of any cash or cash equivalents transferred.

### 3.24 Earnings per Share

The Company calculates basic earnings per share amounts for profit or loss attributable to equity holders of the parent entity and, if presented, profit or loss from continuing operations attributable to those equity holders. Basic earnings per share are calculated by dividing profit or loss attributable to ordinary equity holders of the parent entity (the numerator) by the weighted average number of participating equity instruments outstanding (the denominator) during the period.

The Company's preference shares are considered participating equity instruments for the purpose of earnings per share calculations (see Note 29).

### 3.25 Provisions

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

If the effect of time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as a borrowing cost.

## 3. Summary of Significant Accounting Policies (continued)

### 3.26 Contractual Commitments

Contractual commitments comprise legally binding trading or purchase agreements with stated amount, price and date or dates in the future.

The Company discloses significant contractual commitments in the Notes to the financial statements.

The asset or liability under contractual commitments are not recognized in the financial statement until any of the parties performs in accordance with the contract and until any of the party became legally liable to pay or entitled to receive the payment under the terms of the contract.

### 3.27 Contingent Assets and Contingent Liabilities

A contingent liability is a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Company or a present obligation that arises from past events but is not recognized because it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation or the amount of the obligation cannot be measured with sufficient reliability. The Company does not recognize a contingent liability. A contingent liability is disclosed unless the possibility of an outflow of resources embodying economic benefits is remote.

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Company. The Company does not recognize a contingent asset. A contingent asset is disclosed where an inflow of economic benefits is probable.

### 3.28 Segment Information

The Company provides fixed line and mobile telecommunication services. Management believes that the Company operates in one geographical segment on the territory of the Far East region of the Russian Federation.

### 3.29 Related Party Transactions

The Company defines the following terms to specify the related party: a party is related to the Company if:

1. directly, or indirectly through one or more intermediaries, the party controls, is controlled by, or is under common control with, the Company (this includes parents, subsidiaries and fellow subsidiaries), has an interest in the entity that gives it significant influence over the entity or has joint control over the entity;
2. the party is an associate (as defined in IAS 28 Investments in Associates) of the entity;
3. the party is a joint venture in which the entity is a venturer (see IAS 31 Interests in Joint Ventures);
4. the party is a member of the key management personnel of the entity or its parent;
5. the party is a close member of the family of any individual referred to in (a) or (d);
6. the party is an entity that is controlled, jointly controlled or significantly influenced by, or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in 4 or 5; or
7. the party is a post-employment benefit plan for the benefit of employees of the entity, or of any entity that is a related party of the entity.

Relationships between the parent and its subsidiaries and between subsidiaries themselves are not disclosed by the Company.

## 3. Summary of Significant Accounting Policies (continued)

### 3.30 Events After the Balance Sheet Date

The Company adjusts the amounts recognized in its financial statements to reflect adjusting events after the balance sheet date. Adjusting events are those that provide evidence of conditions that existed at the balance sheet date.

If non-adjusting events after the balance sheet date are material, their nondisclosure could influence the economic decisions of users taken on the basis of the financial statements. Accordingly, the Company discloses the nature of the event and an estimate of its financial effect, or a statement that such an estimate cannot be made for each material category of non-adjusting event after the balance sheet date.

*(in thousands roubles)*

## 4. Segment Information

| | 2005 | | | | |
|---|---|---|---|---|---|
| | **Fixed line** | **Mobile** | **Other** | **Intercompany eliminations** | **Total for the Company** |
| **REVENUE** | | | | | |
| Sales to third parties | 10,013,841 | 547,779 | 134,752 | | **10,696,372** |
| Inter–segment sales | 59,427 | 23,531 | – | (82,958) | – |
| **Total revenue** | **10,073,268** | **571,310** | **134,752** | (82,958) | **10,696,372** |
| **GROSS PROFIT** | | | | | |
| Segment result | 1,509,126 | 160,580 | 49,496 | | **1,719,202** |
| Unallocated corporate expenses | | | | | (359,734) |
| **Operating profit** | | | | | **1,359,468** |
| Share of result of associates | | | | | (334) |
| Gain on sale of subsidiaries, associates and other investments | | | | | 218,748 |
| Other loss from investments, net | | | | | (12,341) |
| Interest expense, net | (433,958) | (27,177) | | | (461,135) |
| Foreign exchange loss, net | | | | | (5,332) |
| Income tax | | | | | (487,617) |
| **Net profit** | | | | | **611,457** |
| **ASSETS AND LIABILITIES** | | | | | |
| Segment assets | 11,893,140 | 927,290 | 152,634 | | 12,973,064 |
| Investments in associates | | | | | 25,969 |
| Unallocated corporate assets | | | | | 1,129,293 |
| **Consolidated total assets** | | | | | **14,128,326** |
| Segment liabilities | (6,070,526) | (274,836) | (23,631) | | **(6,368,993)** |
| Unallocated corporate liabilities | | | | | (902,898) |
| **Consolidated total liabilities** | | | | | **(7,271,891)** |
| **OTHER INFORMATION** | | | | | |
| Capital expenditure | | | | | |
| Fixed assets | 1,603,406 | 50,320 | 20,615 | | 1,674,341 |
| Intangible assets | 141,658 | 3,041 | | | 144,699 |
| Depreciation and amortization | (935,916) | (94,421) | (15,748) | | (1,046,085) |
| Other non–cash expenses (provision for impairment of receivables recovery) | 89,712 | | | | 89,712 |

*(in thousands roubles)*

## 4. Segment Information (continued)

| | 2004 | | | | |
|---|---|---|---|---|---|
| | **Fixed line** | **Mobile** | **Other** | **Intercompany eliminations** | **Total for the Company** |
| **REVENUE** | | | | | |
| Sales to third parties | 8,469,365 | 340,459 | 123,730 | | **8,933,554** |
| Inter–segment sales | | | | | |
| **Total revenue** | **8,469,365** | **340,459** | **123,730** | | **8,933,554** |
| **GROSS PROFIT** | | | | | |
| Segment result | **817,396** | **105,509** | **38,345** | | **961,250** |
| Unallocated corporate expenses | | | | | **(387,723)** |
| **Operating profit** | | | | | **573,527** |
| Share of result of associates | | | | | 232,843 |
| Gain on sale of subsidiaries, associates and other investments | | | | | 573,546 |
| Other gain from investments, net | | | | | 10,669 |
| Interest expense, net | (272,388) | (10,950) | | | (283,338) |
| Foreign exchange gain, net | | | | | 7,070 |
| Income tax | | | | | (430,430) |
| **Net profit** | | | | | **683,887** |
| **ASSETS AND LIABILITIES** | | | | | |
| Segment assets | 11,257,985 | 452,558 | 164,469 | | **11,875,012** |
| Investments in associates | | | | | **26,303** |
| Unallocated corporate assets | | | | | **1,066,418** |
| **Consolidated total assets** | | | | | **12,967,733** |
| Segment liabilities | (5,285,477) | (212,457) | (31,147) | | (5,529,081) |
| Unallocated corporate liabilities | | | | | (820,905) |
| **Consolidated total liabilities** | | | | | **(6,349,986)** |
| **OTHER INFORMATION** | | | | | |
| Capital expenditure | | | | | |
| Fixed assets | 2,671,827 | 107,382 | 43,034 | | 2,822,243 |
| Intangible assets | 281,770 | | | | 281,770 |
| Depreciation and amortization | (866,507) | (34,825) | (13,957) | | (915,289) |
| Other non–cash expenses (provision for impairment of receivables) | (121,633) | | | | (121,633) |

*(in thousands roubles)*

## 4. Segment Information (continued)

The Company provides fixed line and mobile telecommunication services, as well as other services. Management believes that the Company operates in one geographical segment.

Unallocated expenses, assets and liabilities are expenses, assets and liabilities that arise at the entity level and relate to the entity as a whole.

Segment assets consist primarily of property, plant and equipment, intangible assets, inventories, receivables, and operating cash and exclude financial investments, income tax assets and other assets that relate to the entity as a whole. Segment liabilities primarily comprise operating liabilities, loans and leasing liabilities and exclude items such as deferred tax liabilities and other liabilities pertaining to the Company as a whole.

Capital expenditure comprises additions to property, plant and equipment. Provisions relate only to those charges made against allocated assets.

## 5. Property, Plant and Equipment, Net

| | Land, buildings and constructions | Switches and transmission devices | Construction in progress and equipment for installation | Vehicles and other | Total |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| **At December 31, 2003** | **3,711,105** | **4,463,178** | **321,278** | **440,464** | **8,936,025** |
| Additions | | | 2,822,243 | | 2,822,243 |
| Disposals | (10,765) | (18,758) | (8,062) | (2,801) | (40,386) |
| Disposals due to sale of subsidiaries | (9) | (2,231) | (114) | (235) | (2,589) |
| Put into operation | 780,430 | 1,286,632 | (2,368,344) | 301,282 | – |
| **At December 31, 2004** | **4,480,761** | **5,728,821** | **767,001** | **738,710** | **11,715,293** |
| Additions | – | – | 1,674,341 | – | 1,674,341 |
| Additions due to acquisition of subsidiaries | 18,555 | 135,939 | 131,027 | 12,307 | 297,828 |
| Disposals | (75,278) | (178,955) | – | (29,945) | (284,178) |
| Put into operation | 664,500 | 806,698 | (1,664,913) | 193,715 | – |
| **AtDecember31,2005** | **5,088,538** | **6,492,503** | **907,456** | **914,787** | **13,403,284** |
| **Accumulated Depreciation** | | | | | |
| **At December 31, 2003** | **(151,162)** | **(417,253)** | **–** | **(108,016)** | **(676,431)** |
| Charge for the year | (200,163) | (508,003) | – | (202,979) | (911,145) |
| Disposals | 7,754 | 8,303 | – | 1,052 | 17,109 |
| **At December 31, 2004** | **(343,571)** | **(916,953)** | **–** | **(309,943)** | **(1,570,467)** |
| Charge for the year | (211,020) | (571,842) | – | (226,099) | (1,008,961) |
| Disposals | 67,440 | 132,814 | – | 24,191 | 224,445 |
| **At December 31, 2005** | **(487,151)** | **(1,355,981)** | **–** | **(511,851)** | **(2,354,983)** |
| **Net book value as of December 31, 2003** | **3,559,943** | **4,045,925** | **321,278** | **332,448** | **8,259,594** |
| **Net book value as of December 31, 2004** | **4,137,190** | **4,811,868** | **767,001** | **428,767** | **10,144,826** |
| **Net book value as of December 31, 2005** | **4,601,387** | **5,136,522** | **907,456** | **402,936** | **11,048,301** |

*(in thousands roubles)*

## 5. Property, Plant and Equipment, Net (continued)

The net book value of plant and equipment held under finance leases at December 31, 2005 and 2004 amounted to:

| | 2005 | 2004 |
|---|---|---|
| Buildings and constructions | 2,641 | 2,784 |
| Switches and transmission devices | 1,659,582 | 1,519,022 |
| Construction in progress and equipment for installation | 45,188 | 187,999 |
| Vehicles and other FA | 51,575 | 55,861 |
| **Total net book value of plant and equipment held under finance leases** | **1,758,986** | **1,765,666** |

Leased assets are pledged as security for the related finance lease obligations (see Note 19).

In 2005, the Company increased construction in progress by the amount of capitalized interest totaling 54,065 (2004 – 93,360). Capitalization rate in 2005 was 10.4% (2004 – 14%).

Bank borrowings are secured by properties with the carrying value as of December, 31 2005 of approximately 1,218,592 (2004 – 1,077,223) (see Note 18).

## 6. Intangible Assets, Net

| | Goodwill | Licenses | Software | Other | Total |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| **At December 31, 2003** | – | 3,490 | 262,904 | 224 | 266,618 |
| Additions | – | 1,067 | 280,656 | 47 | 281,770 |
| Disposals | – | (324) | (3,947) | – | (4,271) |
| Disposals due to sale of subsidiaries | – | – | – | (21) | (21) |
| **At December 31, 2004** | – | 4,233 | 539,613 | 250 | 544,096 |
| Additions | – | 4,393 | 132,794 | 7,509 | 144,696 |
| Additions due to acquisition of subsidiaries | 76,699 | 172,899 | 9,335 | 19,529 | 278,462 |
| Disposals | – | (2,225) | (34,943) | – | (37,168) |
| **At December 31, 2005** | **76,699** | **179,300** | **646,799** | **27,288** | **930,086** |
| **Impairment** | | | | | |
| **At December 31, 2004** | – | – | – | – | – |
| Reserve | (76,699) | – | | – | (76,699) |
| **At December 31, 2005** | **(76,699)** | **–** | | **–** | **(76,699)** |
| **Accumulated amortization** | | | | | |
| **At December 31, 2003** | – | (1,532) | (8,053) | (123) | (9,708) |
| Charge for the year | – | (1,021) | (3,104) | (19) | (4,144) |
| Disposals | – | 296 | 1,824 | – | 2,120 |
| **At December 31, 2004** | – | (2,257) | (9,333) | (142) | (11,732) |
| Charge for the year | – | (16,293) | (10,198) | (10,633) | (37,124) |
| Disposals | – | 2,221 | 5,692 | – | 7,913 |
| **At December 31, 2005** | **–** | **(16,329)** | **(13,839)** | **(10,775)** | **(40,943)** |
| Net book value at December 31, 2003 | – | 1,958 | 254,851 | 101 | 256,910 |
| Net book value at December 31, 2004 | – | 1,976 | 530,280 | 108 | 532,364 |
| **Net book value at December 31, 2005** | **–** | **162,971** | **632,960** | **16,513** | **812,444** |

## 6. Intangible Assets, Net (continued)

*Oracle E-Business Suite (OEBS)*

As of December 31, 2005 software includes OEBS software including non-exclusive licenses for 4,749 users with a gross book value of 370,369 (2004 – 315,176), including interest capitalized of 54,653 (2004 – 9,023).

Full implementation of Oracle E-Business Suite software is expected to be completed between 2006 and 2008.

The Company will commence amortizing the value of the mentioned software from the date of its implementation, proportionally to the quantity of licenses used, over the useful life of the licenses of 10 years.

*Amdocs Billing Suite*

As of December 31, 2005 software also includes Amdocs Billing Suite software with a gross book value of 227,489 (2004 – 188,341), including the discount on promissory notes capitalized totaling 9,564 (2004 - nil). This software was purchased for the purpose of the implementation of unified automated system. The project of implementation of the unified automated settlements system is expected to last 4-5 years.

Amdocs Billing Suite software was supplied in December 2004 by LLC IBM Eastern Europe/Asia, in exchange for 18 promissory notes with the face value of 232,787. Refer to Note 18.

The Company will commence amortizing this asset from the date of software implementation. Until then the Company annually tests this software for impairment.

*Licenses*

As of December 31, 2005 licenses mainly included GSM 900 licenses with the net book value 152,206 (2004 – 242). The Company measured GSM licenses at cost less any accumulated amortization and any accumulated impairment loss. The remaining useful life of licenses is approximately 7 years.

*Amortization*

Amortization charge for 2005 in the amount of 37,124 (2004 – 4,144) was recorded in line Depreciation and Amortization of Consolidated Statement of Operations.

*Impairment Testing of Goodwill*

Goodwill acquired through business combinations has been allocated to the following cash-generating units for impairment testing:

- CJSC “Sachalinugol Telecom” (fixed line operator)
- LLC “Besprovodnie informatsionnie technologii” (mobile operator)

The recoverable amounts of CJSC “Sachalinugol Telecom” and LLC “Besprovodnie informatsionnie technologii” cash-generating units have been determined based on a value in use calculation using cash flow projections based on financial budgets approved by senior management covering a five-year period. Cash flow beyond the five-year period are extrapolated using a 4% and 10% for CJSC “Sakhalinugol Telecom” and LLC “Besprovodnie informatsionnie technologii”, respectively, that were the same as the long-term average growth rate for the abovementioned cash generating unit. The discount rate applied to cash flow projections was 15% for CJSC “Sakhalinugol Telecom” and 16% for LLC “Besprovodnie informatsionnie technologii”.

*(in thousands roubles)*

## 6. Intangible Assets, Net (continued)

*Impairment Testing of Goodwill (continued)*

The following describes each key assumption applied by the management for cash flow projections to undertake impairment testing of goodwill and licenses:

- Budgeted gross margins – the basis used to determine the value assigned to the budgeted gross margins is the average gross margins achieved in the year immediately before the budgeted year, increased for expected efficiency improvements;
- Bond rate – the yield on five-year Russian government Rouble-denominated bonds at the beginning of the budgeted year.

The carrying amount of goodwill allocated to each of the cash-generating unit was as follows:

| | Carrying amount of goodwill | |
|---|---|---|
| Subsidiary | as of 12/31/2005 | as of 12/31/2004 |
| CJSC "Sachalinugol Telecom" | 21,336 | – |
| LLC "Besprovodnie informatsionnie technologii" | 55,363 | – |
| **Total** | **76,699** | **–** |

As of December 31, 2005 the impairment was identified with respect to these cash-generating units. As a result the impairment loss for the full amount of goodwill was recognized.

*Impairment test of Intangible Assets not yet Available for use*

The Company performed impairment tests of intangible assets not yet available for use. These assets represent cost of Oracle E-Business Suite and Amdocs Billing Suite totaling 597,858 at December 31, 2005 (as at December 31, 2004 – 503,517). As at December 31, 2005 no impairment was identified.

## 7. Consolidated Subsidiaries

The consolidated financial statements include the assets, liabilities and financial results of the Company and its subsidiaries, which main activity is provision of cellular and other telecommunication services. The subsidiaries are listed below:

| Subsidiary | Main Activity | Ownership,% | | Voting Shares | |
|---|---|---|---|---|---|
| | | 2005 | 2004 | 2005 | 2004 |
| LLC "Besprovodnie informatsionnie technologii" | Mobile services | 100 | – | 100 | – |
| CJSC "Sakhalinugol Telecom" | Fixed line telecom services | 100 | – | 100 | – |
| CJSC "Integrator.ru" | Investing activity | 100 | – | 100 | – |
| CJSC "AKOS» (owned by CJSC "Integrator.ru") | Mobile services | 92.26 | – | 92.26 | – |

All the above companies are Russian legal entities registered in accordance with the Russian legislation, and have the same financial year as the Company.

*(in thousands roubles)*

## 7. Consolidated Subsidiaries (continued)

On July 29, 2005 the Company acquired a 100% stake in CJSC “Sakhalinugol Telecom” for 40,000 paid entirely in cash. The subsidiary provides fixed line telecommunication services in the Sakhalin region. Management believes that the fair value of CJSC “Sakhalinugol Telecom’s” identifiable assets, liabilities and contingent liabilities at the date of acquisition approximated their book value.

On April 14, 2005 the Company acquired a 100% stake in LLC “Besprovodnie informatsionnie technologii” for 139,305. The cost of the combination was paid entirely in cash. The subsidiary was purchased for the purpose of rendering cellular services in Sakhalin and Chukotka regions as part of the Company’s mobile business development program. The fair value of identifiable assets, liabilities and contingent liabilities of LLC “Besprovodnie informatsionnie technologii’s” as at the date of acquisition were as follows:

| | **Recognized on acquisition** | **Carrying value** |
|---|---|---|
| Property, plant and equipment, net | 44,623 | 55,553 |
| Intangible assets, net | 30,877 | – |
| Cash and cash equivalents | 1,207 | 1,207 |
| Inventories | 250 | 250 |
| Other current assets | 12,369 | 12,369 |
| **Total Assets** | **89,326** | **69,379** |
| Trade and other payables | (597) | (597) |
| Deferred income tax liability | (4,787) | – |
| **Total liabilities** | **(5,384)** | **(597)** |
| Fair value of net assets | 83,942 | – |
| Group’s share of the fair value of net assets, %% | 100% | – |
| Group’s share of the fair value of net assets | 83,942 | – |
| **Consideration paid** | **139,305** | – |
| **Goodwill arising on acquisition (Note 6)** | **55,363** | **–** |

*(in thousands roubles)*

**7. Consolidated Subsidiaries (continued)**

On May 31, 2005 the Company acquired a 100% stake in CJSC "Integrator.ru" for 99,160 paid entirely in cash. CJSC "Integrator.ru" owns 92.26% of common shares of CJSC "AKOS" which renders cellular services in Primorskiy region. The fair value of identifiable assets, liabilities and contingent liabilities of CJSC "Integrator.ru" and CJSC "AKOS" as at the date of acquisition were:

| | **CJSC "AKOS"** | | **CJSC "Integrator.ru" standalone** | | **CJSC "Integrator.ru" consolidated** | |
|---|---|---|---|---|---|---|
| | **Recognized on acquisition** | **Carrying value** | **Recognized on acquisition** | **Carrying value** | **Recognized on acquisition** | **Carrying value** |
| Property, plant and equipment | 237,558 | 280,316 | – | – | 237,558 | 280,316 |
| Intangible assets, net | 170,886 | 12,819 | – | – | 170,886 | 12,819 |
| Cash and cash equivalents | 1,572 | 1,572 | 746 | 746 | 2,318 | 2,318 |
| Trade and other receivables | 6,314 | 9,020 | 4,243 | 4,243 | 10,557 | 13,263 |
| Inventories | 5,067 | 5,524 | – | – | 5,067 | 5,524 |
| Other current assets | 43,420 | 50,132 | – | – | 43,420 | 50,132 |
| Def tax assets | | 1,068 | – | – | – | 1,068 |
| Other non–current assets | 7,762 | 1,688 | – | – | 7,762 | 1,688 |
| **Total Assets** | **472,579** | **362,139** | **4,989** | **4,989** | **477,568** | **367,128** |
| Trade and other payables | (76,822) | (54,399) | – | – | (76,822) | (54,399) |
| Long–term liabilities | (141,210) | (155,875) | – | – | (141,210) | (155,875) |
| Short–term liabilities | (54,965) | (45,676) | – | – | (54,965) | (45,676) |
| Deferred income tax liability | (28,039) | (6,401) | – | – | (28,039) | (6,401) |
| **Total liabilities** | **(301,036)** | **(262,351)** | – | – | **(301,036)** | **(262,351)** |
| Fair value of net assets | 171,543 | – | 4,989 | – | 176,532 | – |
| Less: minority interests | (13,277) | | – | – | (13,277) | – |
| Group's share of the fair value of net assets, %% | 92.26% | – | 100% | – | – | – |
| Group's share of the fair value of net assets | 158,266 | – | 4,989 | – | 163,255 | – |
| **Consideration paid** | – | – | – | – | **99,160** | – |
| **Goodwill arising on acquisition** | – | – | – | – | **(64,095)** | – |

*(in thousands roubles)*

### 7. Consolidated Subsidiaries (continued)

Management has assigned the acquisition price for the 100% stakes in CJSC “Sakhalinugol Telecom”, LLC “Besprovodnie informatsionnie technologii” and CJSC “Integrator.ru” as follows:

| | **LLC “Besprovodnie informatsionnie technologii”** | **CJSC “Integrator.ru”** | **CJSC “Sakhalinugol Telecom”** | **Total** |
|---|---|---|---|---|
| Acquisition price | 139,305 | 99,160 | 40,000 | 278,465 |
| Transaction costs | – | – | – | – |
| **Total paid** | 139,305 | 99,160 | 40,000 | 278,465 |
| Property, plant and equipment (Note 5) | 44,623 | 237,558 | 15,647 | 297,828 |
| Intangible assets, net (Note 6) | 30,877 | 170,886 | – | 201,763 |
| Cash and cash equivalents | 1,207 | 2,318 | 261 | 3,786 |
| Trade and other receivables | – | 10,557 | 6,211 | 16,768 |
| Inventories | 250 | 5,067 | 1,282 | 6,599 |
| Other current assets | 12,369 | 43,420 | 248 | 56,037 |
| Other non–current assets | – | 7,762 | 311 | 8,073 |
| **Total Assets** | **89,326** | **477,568** | **23,960** | **590,854** |
| Trade and other payables | (597) | (76,822) | (4,480) | (81,899) |
| Long–term liabilities | – | (141,210) | – | (141,210) |
| Short–term liabilities | | (54,965) | (125) | (55,090) |
| Deferred income tax liability (Note 28) | (4,787) | (28,039) | (691) | (33,517) |
| **Total liabilities** | **(5,384)** | **(301,036)** | **(5,296)** | **(311,716)** |
| **Total net assets** | 83,942 | 176,532 | 18,664 | – |
| Less: minority interests | – | (13,277) | – | – |
| Company's share in acquired net assets | 100% | – | 100% | – |
| Assigned value of acquired share in identifiable net assets | 83,942 | 163,255 | 18,664 | – |
| **Amount of goodwill arising on acquisition** | **55,363** | **(64,095)** | **21,336** | – |

The Company’s management considers the excess of the Company’s interest in the net fair value of the identifiable assets, liabilities and contingent liabilities of CJSC “Integrator.ru” and its subsidiary CJSC “AKOS” over the cost of the business combination to be due to bargain purchase. The amount of this excess was recognized in the consolidated financial statement line “Other gain (loss) from investments” after the reassessment of the identification and measurement of the acquirees’ identifiable assets, liabilities and contingent liabilities and the measurement of the cost of the combination.

Goodwill arising on the acquisition of LLC “Besprovodnie informatsionnie technologii” and CJSC “Sakhalinugol Telecom”, which are individual cash generating units, was reviewed for impairment. The impairment was determined to the extent the carrying amounts of these cash-generating units exceed their recoverable amounts and was allocated to the goodwill. Impairment loss is included into the consolidated financial statement line “Other gain (loss) from investments”.

*(in thousands roubles)*

## 7. Consolidated Subsidiaries (continued)

Loss of LLC "Besprovodnie informatsionnie technologii" and CJSC "Integrator.ru" for 2005 year from the dates of acquisition was 14,995 and 6,741, respectively. Profit of CJSC "Sakhalinugol Telecom" for 2005 year from the date of acquisition was 1,347. If the combination had taken place at the beginning of the year, the profit of the Company would have been 871,541 and revenue would have been 10,820,440.

## 8. Investments in Associates

Investments in associates at December 31 comprised the following:

| | | 2005 | | 2004 | |
|---|---|---|---|---|---|
| **Associate** | **Activity** | **Voting shares** | **Carrying value** | **Voting shares** | **Carrying value** |
| LLC Kamalyaskom | Mobile services | 50% | 337 | 50% | 242 |
| LLC Magalyaskom | Mobile services | 50% | 18,209 | 50% | 17,839 |
| CJSC TeleRoss-Vladivostok | Mobile services | 50% | 7,423 | 50% | 8,222 |
| **Total** | | | **25,969** | | **26,303** |

All the above companies are Russian legal entities registered in accordance with Russian legislation and have the same financial year as the Company.

Movement in investments in associates for the years ended December 31, 2005 and 2004 is presented below:

| | 2005 | 2004 |
|---|---|---|
| **Investments in associates at 1 January** | **26,303** | **346,765** |
| Share of income (loss), net of income tax | (334) | 232,843 |
| Dividends received | – | (11,116) |
| Sale of associates | – | (542,189) |
| **Investments in associates at 31 December** | **25,969** | **26,303** |

The carrying value of investments in associates shown in these consolidated financial statements is equivalent to the Company's share in the net assets of the associated companies.

The following table illustrates summarized financial information of the Company's associates.

| Associate | Voting shares | Assets | Liabilities | Revenues | Net income/(loss) |
|---|---|---|---|---|---|
| **2005** | | | | | |
| LLC Kamalyaskom | 50% | 3,147 | (2,471) | 3,874 | 192 |
| LLC Magalyaskom | 50% | 37,149 | (732) | 8,072 | 739 |
| CJSC TeleRoss-Vladivostok | 50% | 15,760 | (915) | 5,755 | (1,598) |
| **2004** | | | | | |
| LLC Kamalyaskom | 50% | 3,506 | (3,022) | 3,929 | 72 |
| LLC Magalyaskom | 50% | 36,064 | (386) | 5,310 | (900) |
| CJSC TeleRoss-Vladivostok | 50% | 21,116 | (4,673) | 24,700 | (40) |

*(in thousands roubles)*

## 9. Financial Investments, Net

As of December 31 the Company's investments comprised the following:

| Company | 2005 Ownership interest | 2005 Carrying value | 2004 Ownership interest | 2004 Carrying value |
|---|---|---|---|---|
| ***Long–term investments*** | | | | |
| OJSC "Svyazintech" | 4% | 4,579 | – | – |
| OJSC SEZ Nakhodka | 8.47% | 1,101 | 8.47% | 1,101 |
| OJSC JSCB Svyazbank | 0.03% | 681 | 0.44% | 687 |
| OJSC Imperial | 19.60% | 240 | 19.60% | 240 |
| OJSC Center of international collaboration | 0.60% | 150 | 0.60% | 150 |
| OJSC A–Svyaz | 6.90% | 128 | 6.90% | 128 |
| OJSC Far East Commercial Bank Dalkombank | – | – | 1.40% | 858 |
| Other | | 553 | | 322 |
| **Total long–term investments** | | **7,432** | | **3,486** |
| ***Short–term investments*** | | | | |
| OJSC Far East Commercial Bank Dalkombank | 1.40% | 858 | – | – |
| OJSC JSCB Nadezhnyi | 0.05% | 18 | – | – |
| OJSC Daltelecom International | – | – | 6.40% | 221,967 |
| OJSC Sberbank | – | – | 0.0005% | 1,405 |
| Other | | 10 | | 50 |
| **Total short–term investments** | | **886** | | **223,422** |
| **Total investments available–for–sale** | | **8,318** | | **226,908** |

Management believes that the carrying amount of these investments approximates their fair values.

*Purchase of Share in OJSC "Svyazintech"*

In accordance with the resolution of the Board of Directors meeting held on February 14, 2005 the Company acquired 4% of shares in OJSC "Svyazintech" for 6. In August 2005 the Company purchased additional 457,256 newly issued ordinary shares of OJSC "Svyazintech" for 4,573 in order to maintain a 4% share.

OJSC "Svyazintech" was established in 2005 for the implementation of Amdocs billing software in the companies of OJSC "Svyazinvest" Group (the parent company).

*(in thousands roubles)*

## 10. Long-term Accounts Receivable and Other Assets

As of December 31, 2005 and 2004 long-term accounts receivable and other assets comprised the following:

| | 2005 | 2004 |
|---|---|---|
| Long-term loans given to employees | 22,545 | 25,305 |
| Long-term accounts receivable | 609 | – |
| **Total** | **23,154** | **25,305** |

As of December 31, 2005 and 2004 long-term loans given to employees are accounted at amortized cost using the effective interest rate of 17% (2004 - 16%).

## 11. Long-Term Advances Given

As of December 31, 2005 and 2004 long-term advances given comprised the following:

| | 2005 | 2004 |
|---|---|---|
| Advances given for capital constructions | 174,791 | 96,725 |
| Acquisition and implementation of Oracle E-Business Suite software and Amdocs Billing Suite software (Note 6) | 105,149 | 41,023 |
| **Total** | **279,940** | **137,748** |

## 12. Inventories

Inventories at December 31, 2005 and 2004 comprised the following:

| | 2005 | 2004 |
|---|---|---|
| Cable, materials, fuel and spare parts for telecommunications equipment | 330,606 | 361,002 |
| Small tools and other inventories | 42,702 | 63,213 |
| Finished goods and goods for resale | 9,550 | 12,348 |
| **Total** | **382,858** | **436,563** |

As of December 31, 2004 no inventories have been pledged as security for borrowings. In 2005 the cost of inventories included in operating expenses in 2005 was 508,076 (2004 - 462,327).

## 13. Accounts Receivable, Net

Accounts receivable as of December 31, 2005 and 2004 comprised the following:

| | 2005 | 2004 |
|---|---|---|
| Trade receivables – telecommunication services | 993,013 | 997,155 |
| Trade receivables – other | 82,211 | 72,780 |
| Provision for impairment of receivables | (248,655) | (437,886) |
| **Total** | **826,569** | **632,049** |

*(in thousands roubles)*

### 13. Accounts Receivable, Net (continued)

Accounts receivable for telecommunication services detailed by major customer groups were as follows:

| | 2005 | 2004 |
|---|---|---|
| Corporate customers | 407,698 | 271,583 |
| Residential customers | 530,529 | 653,164 |
| Government customers | 54,786 | 72,408 |
| **Total** | **993,013** | **997,155** |

The Company invoices its governmental and corporate customers on a monthly basis. The Company sends monthly payment requests and substantially relies upon these customers to remit payments based on the received payment requests. All customer payments are based upon tariffs, denominated in Roubles, in effect at the time the calls are made.

The residential customers group includes receivables on tariff compensation from the state budget in the amount of 123,243 (2004 – 324,023).

The Company made an assessment of the recoverability of these amounts and accrued a provision for impairment of receivables of 123,165 that comprised 99.9% from total accounts receivable for tariff compensation from the state budget.

In 2005 the Company collected from the federal budget receivables for tariff compensation of 103,000.

The following summarizes the changes in the provision for impairment of trade receivables:

| | 2005 | 2004 |
|---|---|---|
| **Balance at January, 1** | 437,886 | 344,231 |
| (Recovery of) Provision for the year | (89,712) | 121,633 |
| Trade receivables write-off | (99,519) | (27,697) |
| Provision disposal due to sale of subsidiary | – | (281) |
| **Balance at December, 31** | **248,655** | **437,886** |

### 14. Other Current Assets, Net

As of December 31, 2005 and 2004 other current assets comprised the following:

| | 2005 | 2004 |
|---|---|---|
| VAT receivable | 359,206 | 393,793 |
| Deferred expenses | 52,424 | 21,151 |
| Prepayments and advance payments | 83,194 | 76,725 |
| Other prepaid taxes | 6,004 | 9,161 |
| Settlements with personnel | 3,974 | 5,793 |
| Short-term loans given | 16,954 | 9,418 |
| Other | 34,908 | 34,167 |
| Provision for impairment of other current assets | (636) | – |
| **Total** | **556,028** | **550,208** |

*(in thousands roubles)*

## 15. Cash and Cash Equivalents

As of December 31, 2005 and 2004 cash and cash equivalents comprised the following:

| | 2005 | 2004 |
|---|---|---|
| Cash on hand and at bank | 153,116 | 128,964 |
| Short-term deposits with a maturity up of three months | 4,900 | – |
| Corporate bank cards in Roubles | 315 | 246 |
| **Total cash and cash equivalents** | **158,331** | **129,210** |

## 16. Significant Non-Cash Transactions

In 2005 the Company purchased property, plant and equipment under vendor financing and finance lease agreements in the amount of 144,987 and 190,155 respectively (2004 - 84,918 and 817,964, respectively).

The Company received equipment contributions in 2005 in the amount of 8,695 (2004 – 4,965).

## 17. Share Capital

Total number of outstanding shares comprises:

| | Number of shares outstanding (thousands) | Total par value | Carrying value |
|---|---|---|---|
| **As at December 31, 2003** | 126,750 | 1,267,503 | 3,098,203 |
| Preference | 31,169 | 623,378 | 1,081,053 |
| Ordinary | 95,581 | 1,911,628 | 3,284,653 |
| **As at December 31, 2004** | 126,750 | 2,535,006 | 4,365,706 |
| Preference | 31,169 | 623,378 | 1,081,053 |
| Ordinary | 95,581 | 1,911,628 | 3,284,653 |
| **As at December 31, 2005** | **126,750** | **2,535,006** | **4,365,706** |

All shares have a par value of 20 Roubles. The difference between the total par value and the total carrying value of share capital represents the effects of inflation accumulated through January 1, 2003.

The ordinary shareholders are entitled to one vote per share.

Preference shares give the holders the right to participate in general shareholders' meetings without voting rights except in instances where decisions are made in relation to re-organization and liquidation of the Company, and in relation to changes and amendments to the Company's charter which restrict the rights of preference shareholders. The preference shares have no rights of redemption or conversion but carry non-cumulative dividends per share of 10% of the Russian accounting net income for the year. If the Company fails to pay the above mentioned dividends, or has no profits in any year, the preferred shareholders have the right to vote in the general shareholders' meeting. Owners of preferred shares have the right to participate in and vote on all issues within the competence of general meetings following the annual general meeting at which a decision not to pay (or to pay partially) dividends on preferred shares has been taken. Annual amount of dividends on preference shares may not be less than dividends on ordinary shares. The preference shareholders participate in earnings along with ordinary shareholders. Accordingly, the Company's preferred shares are considered participating equity instruments for the purpose of earnings per share calculations (refer to Note 29).

*(in thousands roubles)*

**17. Share Capital (continued)**

In a case of liquidation, the property remaining after settlement with creditors, payment of preferred dividends and redemption of the par value of preferred shares is distributed among preferred and ordinary shareholders proportionately to the number of owned shares.

Distributable earnings of the parent company are limited to its respective retained earnings, as mandated by the statutory accounting rules. Statutory retained earnings of the Company as of December 31, 2005 and 2004 amounted to 1,927,681 and 1,285,991, respectively.

In accordance with the Russian legislation, dividends may only be declared to the shareholders of the Company from net income as shown in the Company's Russian statutory financial statements. The Company reported net income of 851,979 and 1,144,189 in its statutory financial statements in 2005 and 2004, respectively.

Dividends were declared in 2005 in respect of 2004 to holders of ordinary shares and preference shares of Rouble 1.2 per ordinary share (2004 – Rouble 0.4 per ordinary share) and Rouble 3.61 per preference share (2004 –Rouble 0.73 per preference share). See also Note 30.

In August 2001 the Company executed a depositary agreement with JP Morgan Chase Bank regarding placement of American Depositary Receipts (ADRs), Level 1. The issue was registered on August 22, 2001. The depositary agreement between the Company and JP Morgan Chase Bank was revised on August 16, 2002 in accordance with the reorganization of the Company. In accordance with the depositary agreement each ADR is equal to 30 ordinary shares of the Company. As of the end of 2005, 52,000 ADRs represented 1,560,000 deposited ordinary shares, which constituted 1.63% of total ordinary shares issued.

The following table represents ADR registration for 2004-2005:

| | ADR (quantity) | Ordinary Shares Equivalent (quantity) | Ordinary Shares % | Charter Capital % |
|---|---|---|---|---|
| **December 31,2003** | **78,866** | **2,365,980** | **2.48%** | **1.87%** |
| Withdrawal 2004 | (27,263) | (817,890) | | |
| **December 31,2004** | **51,603** | **1,548,090** | **1.62%** | **1.22%** |
| Additions 2005 | 397 | 11,910 | | |
| **December 31,2005** | **52,000** | **1,560,000** | **1.63%** | **1.23%** |

Currently the ADRs are traded on the over-the-counter (OTC) market in the United States of America (CUSIP - 30732Q104, ADR ticker - FEEOY).

The Company's shareholding structure as of December 31, 2005 was as follows:

| | **Ordinary shares** | | **Preference shares** | | |
|---|---|---|---|---|---|
| | **Number (thousands)** | **%** | **Number (thousands)** | **%** | **Total** |
| OJSC "Svyazinvest" | 48,331 | 50.57 | – | – | 48,331 |
| Other legal entities | 40,235 | 42.10 | 22,232 | 71.33 | 62,467 |
| ADR holders | 1,560 | 1.63 | – | – | 1,560 |
| Individuals | 5,455 | 5.70 | 8,937 | 28.67 | 14,392 |
| **Total** | **95,581** | **100.00** | **31,169** | **100.00** | **126,750** |

*(in thousands roubles)*

## 18. Borrowings

As of December 31, 2005 and 2004 borrowings comprised the following:

| | Interest rate | Maturity date | 2005 | 2004 |
|---|---|---|---|---|
| ***Short–term borrowings*** | | | | |
| Bank loans (Roubles) | 8–13% | 2006 | 272,000 | 100,000 |
| Accrued interest on bank loans (Roubles) | | | 2,683 | 1,490 |
| Accrued interest on promissory notes (Roubles) | | | 42,562 | – |
| Accrued interest on promissory notes (US Dollars) | | | 4,980 | – |
| Accrued interest on bonds (Roubles) | | | 16,027 | 18,492 |
| Accrued interest on vendor financing (US Dollars) | | | 344 | 391 |
| **Total short–term borrowings** | | | **338,596** | **120,373** |
| ***Long–term borrowings*** | | | | |
| Bank loans (Roubles) | 10.5–13% | 2006–2008 | 845,435 | 317,000 |
| Bonds (Roubles) | 13–15% | 2006 | 1,000,000 | 1,000,000 |
| Vendor financing (Euro) | 8% | 2006–2008 | 42,369 | 51,993 |
| Vendor financing (US Dollars) | 5.4–10% | 2006–2008 | 99,661 | – |
| Promissory notes (Roubles) | 13–14% | 2006 | 342,000 | 53,591 |
| Promissory notes (US Dollars) | 6.0–8.5% | 2006 | 122,840 | 329,156 |
| **Total long term borrowings** | | | **2,452,305** | **1,751,740** |
| Less: Current portion of long–term borrowings | | | (1,726,362) | (1,238,521) |
| **Total long–term borrowings** | | | **725,943** | **513,219** |

As of December 31, 2005 bank loans are secured by property, plant and equipment with the carrying value of approximately 1,218,592 (2004 – 1,077,223).

As of December 31, 2005, borrowings had the following maturity schedule:

| Maturity date | Bank loans | Bonds | Vendor financing | Promissory notes | Total |
|---|---|---|---|---|---|
| 2006 | 451,345 | 1,016,027 | 85,204 | 512,382 | 2,064,958 |
| 2007 | 344,500 | – | 52,395 | – | 396,895 |
| 2008 | 324,273 | – | 4,775 | – | 329,048 |
| **Total** | **1,120,118** | **1,016,027** | **142,374** | **512,382** | **2,790,901** |

The Company's borrowings are denominated in the following currencies:

| Currency | 2005 | 2004 |
|---|---|---|
| Russian Roubles | 2,520,707 | 1,490,573 |
| US dollars | 227,825 | 329,547 |
| Euro | 42,369 | 51,993 |
| **Total** | **2,790,901** | **1,872,113** |

The Company has not entered into any hedging arrangements in respect of its foreign currency obligations or interest rate exposures.

## 18. Borrowings (continued)

**Short-term Borrowings**

**Bank Loans**

All short-term borrowings denominated in Roubles represent bank loans received to finance working capital. Most of these loans are collateralized with telecommunications equipment.

*OJSC Svyaz Bank*

In August 2005 the Company entered into a loan agreement with Svyazbank. The loan matures in 2006. The loan bears interest of 12%. As of December 31, 2005, the outstanding amount was 200,000. The loan is not secured.

*OJSC Sberbank*

In May 2005 the Company entered into two loans agreements with Sberbank. The loans mature in 2006. The loans bear interest of 10%. As of December 31, 2005, the outstanding amount was 72,000. The loans are secured with property, plant and equipment valued at 97,006.

**Long-term Loans and Borrowings**

**Bank Loans**

*OJSC Sberbank*

Long-term borrowings from Sberbank represent Rouble denominated loans received in 2004-2005. The loans mature in March and December 2006. The loans bear interest of 10.5%. As of December 31, 2005, the outstanding amount was 174,000. The loans are secured with property, plant and equipment valued at 277,081.

*OJSC Vneshtorgbank*

Long-term borrowings from Vneshtorgbank represent Rouble denominated loans received in 2004-2005. The loans mature in 2007-2008. The loans bear interest of 10.5-13%. As of December 31, 2005, the outstanding amount was 278,000. The loans are secured with property, plant and equipment valued at 406,807.

*OJSC Dalcombank*

Long-term borrowings from Dalcombank represent Rouble denominated loans received in 2004. The loans mature in 2007. The loans bear interest of 13%. As of December 31, 2005, the outstanding amount was 63,000. The loans are secured with property, plant and equipment valued at 92,854.

*MDM-Bank*

Long-term borrowings from MDM-bank represent Rouble denominated loans received in 2004. The loans mature in 2007. The loans bear interest at 11%. As of December 31, 2005, the outstanding amount was 70,000. The loans are not secured.

*Syndicated Loans OJSC Rossiyskyi Bank Razvitiya and OJSC Svyaz Bank*

Syndicated loans represent Rouble denominated loans received in 2005. The loans mature in 2008. The loans bear interest of 11%. As of December 31, 2005, the outstanding amount was 220,000. The loans are secured with property, plant and equipment valued at 344,846.

*(in thousands roubles)*

## 18. Borrowings (continued)

**Long-term Loans and Borrowings (continued)**

### Bonds

In July 2003, the Company registered the issue of 1,000,000 interest-bearing bonds, par value of 1,000 Roubles each. The bonds have 6 quarterly coupons. The bonds mature in 1,092 days from the date of issue.

Coupon interest rate is as follows:

| Coupon number | Start date of coupon period | Coupon interest, % per annum | Coupon maturity date |
|---|---|---|---|
| 1 | November 19, 2003 | 14.5 | May 19, 2004 |
| 2 | May 19, 2004 | 14.5 | November 17, 2004 |
| 3 | November 17, 2004 | 15.0 | May 18, 2005 |
| 4 | May 18, 2005 | 15.0 | November 16, 2005 |
| 5 | November 16, 2005 | 13.0 | May17, 2006 |
| 6 | May17, 2006 | 13.0 | November 15, 2006 |

The interest obligation was discharged within the time period prescribed by Prospectus for bond issue.

### Vendor Financing

*IskrauralTel*

In 2004-2005 the Company entered into several agreements with IskrauralTel denominated in Euro, under which it delivered telecommunication equipment to the Company. These agreements bear an effective interest rate of 8%. The amount outstanding as of December 31, 2005 was 42,369. Equipment received under these agreements is pledged to the supplier until the final payment is made.

*BETO-Huawei*

In 2003-2005 the Company entered into several agreements with Beto-Huawei denominated in US Dollar, under which it delivered telecommunication equipment to the Company. These agreements bear an effective interest rate of 5.4-10%. The amount outstanding as of December 31, 2005 was 94,844. Equipment received under these agreements is pledged to the supplier until the final payment is made.

*Soft-Pro*

In 2005 the Company entered into several agreements with Soft-Pro denominated in US Dollar, under which it delivered telecommunication equipment to the Company. These agreements bear an effective interest rate of 5.4-10%. The amount outstanding as of December 31, 2005 was 4,816. Equipment received under these agreements is pledged to the supplier until the final payment is made.

*(in thousands roubles)*

## 18. Borrowings (continued)

**Long-term loans and borrowings (continued)**

**Promissory Notes**

In December, 2004 the Company purchased Amdocs Billing Suite software from IBM Eastern Europe/Asia. In this connection the Company issued US dollar denominated promissory notes in the amount of 232,787. The outstanding amount of these notes as at December 31, 2005 was 81,395.

In 2005 the Company entered into several agreements on issue of promissory notes denominated in Roubles with Vneshtorgbank. The notes mature in 2006. As of December 31, 2005, the outstanding amount was 342,000.

In 2003 the Company issued promissory notes denominated in US dollars to Alfabank. The notes mature in 2006. These agreements bear an effective interest rate of 6%. As of December 31, 2005 the outstanding amount was 41,445.

## 19. Finance Lease Obligations

The Company has finance lease contracts for telecommunication equipment. Future minimum lease payments under finance lease contracts together with the present value of the net minimum lease payments as of December 31, 2005 and 2004 are as follows:

| | 2005 | | 2004 | |
|---|---|---|---|---|
| | **Minimum lease payments** | **Present value of payments** | **Minimum lease payments** | **Present value of payments** |
| Current portion | 580,241 | 349,791 | 623,454 | 343,262 |
| 2 to 5 years | 1,115,779 | 867,626 | 1,482,325 | 1,063,904 |
| Over 5 year | – | – | 884 | 630 |
| **Total minimum lease payments** | **1,696,020** | **1,217,417** | **2,106,663** | **1,407,796** |
| Less amounts representing finance charges | (478,603) | – | (698,867) | – |
| **Present value of minimum lease payments** | **1,217,417** | **1,217,417** | **1,407,796** | **1,407,796** |

In 2005 and 2004 the Company's primary lessors were OJSC "RTC-Leasing" and LLC "Promsvyazleasing". In 2005, the effective interest rate on lease liabilities ranged from 20% to 34% per annum (2004 - 20% to 35% per annum).

OJSC "RTC-Leasing" purchases telecommunication equipment from domestic and foreign suppliers and provides such equipment to the Company under finance lease agreements. The Company's obligations under finance leases to OJSC "RTC-Leasing" as of December 31, 2005 amounted to 1,133,553 (2004 – 1,281,664).

Guarantees issued to OJSC "RTC-Leasing" are described in Note 31.

OJSC "RTC-Leasing" is entitled to adjust the lease payment schedule in the event of a change in certain economic conditions, in particular, a change in the refinancing rate of the Central Bank of the Russian Federation.

*(in thousands roubles)*

## 20. Accounts Payable, Accrued Expenses and Advances Received

As of December 31, 2005 and 2004 the Company's accounts payable, accrued expenses and advances received comprised the following:

| | 2005 | 2004 |
|---|---|---|
| Accounts payable for capital investments | 149,467 | 514,049 |
| Trade accounts payable | 138,478 | 155,800 |
| Advances received from subscribers | 301,598 | 242,409 |
| Salaries and wages | 729,516 | 492,833 |
| Other accounts payable | 71,909 | 57,113 |
| **Total** | **1,390,968** | **1,462,204** |

Other accounts payable include outstanding settlements with insurance providers, payments to Non-Commercial Partnership (Note 33) and other.

## 21. Other Taxes Payable

### *Current Taxes Payable*

As of December 31, 2005 and 2004, taxes payable comprised the following:

| | 2005 | 2004 |
|---|---|---|
| Value-added tax | 281,079 | 251,651 |
| Individual income tax | 11,506 | 16,866 |
| Property tax | 39,830 | 27,107 |
| Unified social tax | 41,354 | 29,693 |
| Other taxes | 5,176 | 4,535 |
| **Total** | **378,945** | **329,852** |

Included in value added tax payable is the amount of 159,132 (2004 – 157,114), which represents deferred value added tax, that is only payable to the tax authorities when the underlying receivables are recovered or written off.

Starting January 1, 2006 amendments to the Tax Code relating to rules of determination of the taxable base were introduced. These are described in Note 35 "Subsequent Events".

### *Long-Term Taxes Payable*

Long-term taxes payable comprise various taxes payable to the Russian Government which were previously past due and which have been restructured to be repaid over a period of up to 10 years following the application of Government Resolution No. 1002 dated September 3, 1999.

*(in thousands roubles)*

## 22. Pensions and Other Post-Employment Benefits

In addition to statutory pension benefits the Company also contributes to post-employment benefit plans, which cover most of its working and former employees.

The defined benefit pension plan provides old age retirement pension and disability pension. The plans provide for payment of retirement benefits starting from statutory retirement age, which is currently 55 for women and 60 for men. According to the plan terms the pensions are defined monetary values which depend on participants' positions and past service in the Company at retirement and do not depend on their wages. The benefits do not vest until and are subject to the employee retiring from the Company on or after the above-mentioned ages.

Non-government pension fund Telecom-Soyuz, which is related to the Company, maintains the defined benefit pension plan. The Company makes contributions to the pension fund in the amount set forth in the agreement with the pension fund (Note 33).

The Company further provides other long-term employee benefits such as a death-in-service payments and lump-sum payment upon retirement of a defined benefit nature. Additionally the Company provides death-in-pension payments and financial support of a defined benefit nature to its old age and disabled pensioners.

There were 16,964 active employees participating to the defined benefit pension plan of the Company and 1,674 pensioners eligible to the post-employment and post-retirement benefits, as of December 31, 2005 (as of December 31, 2004 – 18,964 and 895 respectively).

As of December 31, 2005 and 2004 the net liabilities of defined benefit pension and other post-employment benefit plans comprised the following:

| | 2005 | 2004 |
|---|---|---|
| Present value of defined benefit obligation | 999,187 | 696,000 |
| Fair value of plan assets | (173,128) | (160,000) |
| Present value of unfunded obligations | 826,059 | 536,000 |
| Unrecognized past service cost | (411,969) | (275,000) |
| Unrecognized actuarial (losses)/gains | (37,685) | (30,000) |
| **Net pension liability in the balance sheet** | **376,405** | **231,000** |

As of December 31, 2005 management estimated employees' average remaining working life at 8 years (2004 - 15 years).

The movements in the net liability for defined benefit pension and other post-employment benefit plans in 2005 and 2004 are as follows:

| | 2005 | 2004 |
|---|---|---|
| **Net liability at January 1** | 231,000 | 182,000 |
| Net expense for the year | 154,413 | 107,000 |
| Contributions | (9,008) | (58,000) |
| **Net liability at December 31** | **376,405** | **231,000** |

*(in thousands roubles)*

## 22. Pensions and Other Post-Employment Benefits (continued)

Movements in the net assets of defined benefit pension and other post-employment benefit plans during 2005 and 2004 are characterized by the following factors:

| | 2005 | 2004 |
|---|---|---|
| **Fair value of plan assets at January 1** | 160,000 | 102,000 |
| Actual return on plan assets | 20,769 | 14,000 |
| Employer contributions | 9,008 | 58,000 |
| Benefits paid | (16,649) | (14,000) |
| **Fair value of plan assets at December 31** | **173,128** | **160,000** |

Actual return on plan assets for 2005 was 13.3%.

The amount of net expense for the defined benefit pension and other post-employment benefit plans recognized in 2005 and 2004 is as follows:

| | 2005 | 2004 |
|---|---|---|
| Interest cost | 66,934 | 58,000 |
| Service cost | 40,998 | 37,000 |
| Expected return on plan assets | (14,571) | (11,000) |
| Actuarial gains/(losses) | – | – |
| Amortization of past service cost – non–guaranteed potion | 23,000 | 23,000 |
| Past service cost recognized in current year | 38,052 | – |
| **Net expense for the defined benefit pension plans** | **154,413** | **107,000** |

The amount of net expense for the defined benefit pension and other post-employment benefit plans is included in the consolidated statement of operations line "Wages, salaries, other benefits and payroll taxes".

As of December 31, 2005 and 2004 the principle actuarial assumptions of defined benefit pension and other post-employment benefit plans were as follows:

| | 2005<br>Per annum | 2004<br>Per annum |
|---|---|---|
| Discount rate | 7% | 9.18% |
| Expected return on plan assets | 9.96% | 9.33% |
| Future salary increases | 8.15% | 9.18% |
| Rate used for calculation of annuity value | 6% | 6% |
| Increase in financial support benefits | 5% | 6% |
| Staff turnover | 7.00% | 2.25% |
| **Mortality tables (source of information)** | **USSR 1985/86** | **Russia 1998** |

During 2005 the Company introduced changes to the defined benefit pension plans, thus extending its liabilities under pension agreements.

As of December 31, 2005 the plan assets of the defined benefit pension plan did not include the Company's financial instruments (2004 - included the Company's bonds representing 1% of the total plan assets).

*(in thousands roubles)*

## 23. Revenues

Revenues for the years ended December 31, 2005 and 2004 comprised the following:

| By revenue types | 2005 | 2004 |
|---|---|---|
| Long distance telephone services – domestic | 3,097,836 | 2,880,660 |
| Local telephone calls | 2,843,161 | 2,146,724 |
| Revenues from national operators | 1,217,952 | 694,739 |
| New services | 800,721 | 499,540 |
| Cellular services | 553,375 | 358,811 |
| Long distance telephone services – international | 546,503 | 524,012 |
| Installation and connection fees | 494,542 | 728,680 |
| Radio and TV broadcasting | 173,221 | 180,061 |
| Data transfer and telemetric services | 156,671 | 160,853 |
| Rent of telephone channels | 142,764 | 126,666 |
| Documentary services | 27,889 | 33,267 |
| Other telecommunications services | 445,026 | 427,869 |
| Other revenues | 196,711 | 171,672 |
| **Total** | **10,696,372** | **8,933,554** |

The Company identifies revenue by the following major customer groups:

| Customer groups | 2005 | 2004 |
|---|---|---|
| Residential customers | 5,811,513 | 5,021,701 |
| Corporate customers | 3,914,817 | 3,027,008 |
| Government customers | 970,042 | 884,845 |
| **Total** | **10,696,372** | **8,933,554** |

The residential customers group includes revenues on tariff compensation from the state budget in amount 504 (2004 – 314,530).

*(in thousands roubles)*

## 24. Other Operating Expenses, Net

Other operating expenses, net comprised the following:

| | 2005 | 2004 |
|---|---|---|
| Fire and other security services | 157,092 | 129,603 |
| Lease of premises | 134,455 | 92,658 |
| Business travel expenses and representation costs | 53,631 | 70,825 |
| Universal service fund payments | 53,387 | – |
| Civil Defense | 50,140 | 39,432 |
| Insurance | 52,879 | 46,677 |
| Advertising expenses | 52,365 | 31,767 |
| Agency fees | 48,230 | 20,409 |
| Audit and consulting fees | 46,662 | 49,009 |
| Non-commercial partnership expenses (Note 33) | 45,873 | 60,500 |
| Social expenses | 25,793 | 16,895 |
| Member fees, charity contribution, payments to labor unions | 23,844 | 29,676 |
| Transportation services | 20,500 | 77,147 |
| Post services | 12,046 | 7,485 |
| Education expenses | 11,733 | 16,557 |
| Cost of goods sold | 9,564 | 13,038 |
| Telecommunication regulatory fees | – | 26,631 |
| AR written-off | 15,846 | 9,813 |
| Banks service fees | 27,002 | 31,146 |
| Compensations to Board of Directors members and Revision Committee | 37,572 | 33,757 |
| Other expenses | 141,576 | 124,451 |
| **Total** | **1,020,190** | **927,476** |

In 2005 the Company incurred an expense on payments to Universal service fund. These payments are prescribed by the Federal Law on Communications and Government Decree # 243 of April 21, 2005. Payments are calculated as 1.2% of the revenues from the telecommunication services less revenues from interconnection services. Related contingency is disclosed in Note 31.

Other expenses include expenses related to fines and penalties, billing and cash collection services and other operating expenses.

## 25. Interest Expense, net

Interest expense, net for the years ended December 31, 2005 and 2004 comprised the following:

| | 2005 | 2004 |
|---|---|---|
| Interest income | (14,376) | (6,260) |
| Interest expense on borrowings | 165,336 | 76,899 |
| Interest expense accrued on finance leases | 309,720 | 212,060 |
| Interest expense on vendor financing | 455 | 638 |
| **Total** | **461,135** | **283,337** |

*(in thousands roubles)*

## 26. Gain on Sale of Subsidiaries, Associates and Other Investments

Gain from sale of subsidiaries, associates and other investments for the years ended December 31, 2005 and 2004 comprised the following:

| | 2005 | 2004 |
|---|---|---|
| Gain on sale of CJSC "Sotovye Sety Birobidjana" | – | 3,513 |
| Gain on sale of associates | – | 564,279 |
| Gain on sale of other investments | 218,748 | 5,754 |
| **Total** | **218,748** | **573,546** |

## 27. Other Gain (Loss) From Investments, Net

Other gain (loss) from investments for the years ended December 31, 2005 and 2004 comprised the following:

| | 2005 | 2004 |
|---|---|---|
| Excess of the Company's interest in the net fair value of CJSC "Integrator" over the cost of the business combination | 64,095 | – |
| Loss from impairment of goodwill arising on the acquisition of LLC "Besprovodnye informatsionnie technologii" | (55,363) | – |
| Loss from impairment of goodwill arising on the acquisition of CJSC "Sakhalinugol Telecom" | (21,336) | – |
| (Provision for) recovery of impairment of other investments | (5) | 10,417 |
| Dividend income | 268 | 252 |
| **Total** | **(12,341)** | **10,669** |

## 28. Income Tax

Income tax charge for the years ended December 31, 2005 and 2004 comprised the following:

| | 2005 | 2004 as restated |
|---|---|---|
| Current income tax expense | 439,059 | 497,159 |
| Deferred tax expense | 48,558 | (66,729) |
| **Total income tax for the year** | **487,617** | **430,430** |

A reconciliation of the theoretical tax charge to the actual income tax charge is as follows:

| | 2005 | 2004 as restated |
|---|---|---|
| **Profit before income tax and minority interest** | 1,099,074 | 1,114,317 |
| Statutory income tax rate | 24% | 24% |
| Theoretical tax charge at statutory income tax rate | **263,778** | **267,436** |
| **Increase (decrease) resulting from the effect of:** | | |
| Non-taxable income | (18,252) | (10,090) |
| Non-deductible expenses | 242,091 | 173,084 |
| **Total income tax charge for the year** | **487,617** | **430,430** |
| Effective tax rate | **44.37%** | **38.63%** |

*(in thousands roubles)*

## 28. Income Tax (continued)

Deferred income tax assets and liabilities as of December 31, 2005 and 2004 were as follows:

| | December 31, 2003 | Origination and reversal of temporary differences, as restated | Sale of subsidiaries | December 31, 2004, as restated | Originatio n and reversal of temporary differences | Subsidiaries acquisition | December 31, 2005 |
|---|---|---|---|---|---|---|---|
| *Deferred tax assets:* | | | | | | | |
| Property, plant and equipment | – | – | – | – | (2,836) | 10,951 | 8,115 |
| Accounts payable and accrued expenses | 76,087 | 23,183 | – | 99,270 | (701) | 4,435 | 103,004 |
| Provision for impairment of receivables | 31,612 | 18,702 | – | 50,314 | (41,367) | – | 8,947 |
| Pension liability | – | – | – | – | 38,518 | – | 38,518 |
| Finance lease | 9,823 | (9,823) | – | – | 10,675 | – | 10,675 |
| Deferred revenue | 23,860 | 273 | – | 24,133 | 805 | – | 24,938 |
| Other | 3,591 | 7,580 | – | 11,171 | 6,581 | – | 17,752 |
| **Deferred tax asset, total** | **144,973** | **39,915** | **–** | **184,888** | **11,675** | **15,386** | **211,949** |
| *Deferred tax liabilities:* | | | | | | | |
| Property, plant and equipment | (892,124) | (25,558) | (168) | (917,850) | (75,977) | (714) | (994,541) |
| Intangible assets | (2,988) | (7,957) | – | (10,945) | 1,520 | (48,189) | (57,614) |
| Finance lease | – | (13,361) | – | (13,361) | 13,361 | – | – |
| Investments into associates | (74,679) | 73,476 | – | (1,203) | 863 | – | (340) |
| Investment revaluation effect | (805) | (49,746) | – | (50,551) | 50,551 | – | – |
| Other | (214) | 214 | – | – | – | – | – |
| **Deferred income tax liability, total** | **(970,810)** | **(22,932)** | **(168)** | **(993,910)** | **(9,682)** | **(48,903)** | **(1,052,495)** |
| **Total deferred income tax liability, net** | **(825,837)** | **16,983** | **(168)** | **(809,022)** | **1,993** | **(33,517)** | **(840,546)** |

The movement in deferred tax asset for the years ended December 31, 2005 and 2004 was as follows:

| | 2005 | 2004 as restated |
|---|---|---|
| **Deferred tax asset, at January 1** | 184,888 | 144,973 |
| Deferred tax income | 11,675 | 39,915 |
| Subsidiary acquisition | 15,386 | – |
| **Deferred tax asset, at December 31** | **211,949** | 184,888 |

The movement in deferred tax liability for the years ended December 31, 2005 and 2004 was as follows:

| | 2005 | 2004 as restated |
|---|---|---|
| **Deferred tax liability, at January 1** | (993,910) | (970,810) |
| Deferred tax (expense) income | (60,233) | 26,814 |
| Deferred tax expense related to changes in fair value of investments available-for-sale | 50,551 | (49,746) |
| Subsidiary acquisition | (48,903) | – |
| Deferred tax liabilities of subsidiaries disposed | – | (168) |
| **Deferred tax liability at December 31** | **(1,052,495)** | (993,910) |

*(in thousands roubles)*

## 29. Earnings per Share

Basic earnings per share amounts are calculated by dividing the net income attributable to participating shareholders by the weighted average number of shares in issue during the period.

The calculation of basic and diluted earnings per preferred and ordinary share is presented below (earnings per share data is stated in Rouble):

| | **2005** | **2004, as restated** |
|---|---|---|
| **Profit/(loss) for the year attributable to equity holders of the parent** | 613,035 | 683,887 |
| Weighted average number of shares outstanding (thousands) (see Note 17) | 126,750 | 126,750 |
| **Basic and diluted earnings per share attributable to equity holders of the parent, Russian Roubles** | **4.837** | **5.396** |

The Company has no dilutive potential ordinary shares; therefore, the diluted earnings per share equal basic earnings per share.

## 30. Dividends Declared and Proposed for Distribution

Dividends paid to shareholders are determined by the Board of Directors and declared and officially approved at the annual shareholders' meeting. Earnings available for dividends are limited to profits determined in accordance with the Russian statutory accounting regulations. Dividends are accrued in the year they are declared and approved.

*Dividends declared in 2005 based on 2004 results:*

| | |
|---|---|
| Dividends on ordinary shares – 1.20 Roubles per share | 114,697 |
| Dividends on preference shares – 3.61 Roubles per share | 112,520 |
| **Total** | **227,217** |

*Dividends declared and approved subsequent to December 31, 2005 (Note 35):*

| | |
|---|---|
| Dividends on ordinary shares – 0.90 Rouble per share | 86,023 |
| Dividends on preference shares – 2.69 Rouble per share | 83,844 |
| **Total** | **169,867** |

## 31. Contingencies and Operating Risks

### *Operating Environment of the Company*

The Russian economy while deemed to be of market status continues to display certain characteristics consistent with that of a market in transition. These characteristics include, but are not limited to, relatively high inflation and the existence of currency controls which cause the national currency to be illiquid outside of Russia. The stability of the Russian economy will be significantly impacted by the government's policies and actions with regards to supervisory, legal, and economic reforms.

### *Legal Environment*

The Russian legal system is characterized by (1) inconsistencies between and among laws, Presidential decrees, and Russian governmental, ministerial and local orders, decisions, and resolutions and other acts; (2) conflicting local, regional and federal rules and regulations; (3) the lack of judicial and administrative guidance on interpreting legislation; (4) the relative inexperience in legislation interpretation; and (5) a high degree of discretion on the part of governmental authorities.

Management is unable to estimate what developments may occur in respect if the Russian legal system or the resulting effect of any such developments on the Company's financial position or future results of operations.

In the nearest future the Company's activity could be subject by judicial reform factors. No adjustments related to these uncertainties were recognized in the consolidated statements.

### *Legal Proceeding*

On November 3, 2005 the Federal Antimonopoly Agency adjudicated that the Company violated the legislation in regard to item 1 of the Article 5 of the Law "On Competition and Restriction of Monopoly Activity on Commodity Markets" No. 948-1 dated March 22, 1991 as a result of setting and maintaining the monopolistic high prices and creation of unequal conditions for economic entities in accessing the produce market.

In connection with this fact the Federal Antimonopoly Agency issued a decision to the Company to cease violating the antimonopoly legislation and to remit to the Federal budget the amount of income received as a result of this practice. In accordance with the abovementioned decision the Company was obliged to remit to the Federal budget 205,768 not later than March 3, 2006.

The Company considers these decisions issued by the Federal Antimonopoly Agency as illegal and infringing the rights and legitimate interests of the Company in the sphere of entrepreneurial and other economic activities. Accordingly the Company seized the Arbitration Court of the Moscow City with the respective claim. In a first court session on April 4, 2006 the trial was postponed until July 12, 2006.

The management believes that the Company has arguments sufficient for successful legal defense against the claims enforcement. However, as of now the court perspective of such claims seems to be unclear.

### *Taxation*

Russian tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Company may be challenged by the relevant regional and federal authorities. Recent events within the Russian Federation suggest that the tax authorities are taking a more assertive position in its interpretation of the legislation and assessments and as a result, it is possible that transactions and activities that have not been challenged in the past may be challenged. As such, significant additional taxes, penalties and interest may be assessed. It is not practical to determine the amount of unasserted claims that may manifest, if any, or the likelihood of any unfavorable outcome. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

## 31. Contingencies and Operating Risks (continued)

***Claims of tax authorities***

During 2004 a tax examination of the Company's operations for the years 2001-2002 was executed by the tax authorities. As a result, the Company received a claim totaling 718,080, including fines and penalties of 256,245.

As of December 31, 2005 the management believes that its interpretation of the relevant legislation is appropriate and that it is probable that the Company's tax, currency and customs positions will be sustained. As such, no provision has been made for the above mentioned claim. However, as of now court perspective of such tax claims seems to be unclear in view of court practice absence.

***Insurance Coverage***

During 2005 the Company did not maintain insurance coverage on a significant part of its property, plant and equipment, business interruption losses, or third party liability in respect of property or environmental damage arising from accidents relating to the Company's property or the Company's operations. Until the Company obtains adequate insurance coverage, there is a risk that losses resulting from destruction of certain assets could have a material adverse effect on the Company's operations and financial position.

***Licenses***

Substantially all of the Company's revenues are derived from operations conducted pursuant to licenses granted by the Russian Government. These licenses expire in various years ranging from 2007 to 2012. The Company has renewed these licenses on a regular basis in the past, and believes that it will be able to renew the licenses without additional cost in the normal course of business. Suspension or termination of the Company's main licenses or any failure to renew any or all of these main licenses could have a material adverse effect on the financial position and operations of the Company.

The Government of the Russian Federation is in process of liberalization of the telecommunications market for which additional licenses on providing of DLD/ILD have been granted to a number of alternative operators. It is possible that the Company's future results of operations or cash flows could be materially affected in a particular period but these effects can not be currently determined.

The Decision of the Russian Government # 87 "On Endorsement of the list of the names of communication services entered in licenses and the lists of license terms" of February 18, 2005 (amended as at December 29, 2005 # 837) prescribed types of connection services that are to be included into licenses and list of licensing terms. Licensing terms defined in previously issued licenses are effective unless they contradict the current regulations. The Company considered significant effect of new requirements related to the interconnection settlements, traffic transmission and mobile services on current licensing terms for licenses issued prior to January 1, 2004. At current the Company is in process of receipt necessary amendments to the licenses.

***Employee Redundancy Program***

As part of the enhancement of the efficiency the Company embraced the Employee Redundancy Program approved by the order of General Director No. 380 dated December 26, 2005.

In December 2005 the Company accrued contingent liabilities for compensation payments to employees which are to be dismissed according to the Program. The related expenses of 67,465, are included in the consolidated statement of operations line "Wages, salaries, other benefits and payroll taxes".

## 31. Contingencies and Operating Risks (continued)

### *Guarantees Issued*

The Company mainly guaranteed credit line facilities provided by Sberbank and Rosbank to OJSC "RTC-Leasing", a lessor of telecommunication equipment, as of December 31, 2005 (Note 19). The guarantees amounted to 1,946,342 (2004 – 1,816,342).

The total amount of guarantees issued to third parties amounted to the 1,993,617 (2004 – 1,863,617).

### *Universal Service Fund Payments*

Industry regulations effective as of December 31, 2005 did not provide clear guidance with respect to the method of calculation of the allocation to the fund. Accordingly an uncertainty exists regarding the accuracy of calculation of the payments to this fund.

## 32. Contractual Commitments

### *Finance Leases*

In 2005 the Company entered into several finance leases with OJSC "RTC-Leasing". The equipment under these leases will be delivered in 2006. The cost of equipment acquired through these leases, inclusive of installation and other capitalized services approximated to 103,164.

### *Capital Investments*

As of December 31, 2005 the Company has commitments for capital investments into the modernization and expansion of its network in the amount of 513,540 (2004 – 721,811).

## 33. Balances and Transactions with Related Parties

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

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

The nature of the related party relationships for those related parties with whom the Company entered into significant transactions or had significant balances outstanding at December 31, 2005 are detailed below.

### *Transactions with Government Organizations*

Government organizations are a significant element in the Company's customer base, purchasing services both directly through numerous authorities and indirectly through their affiliates. Certain entities financed by the Government budget are users of the Company's network. These entities are generally charged lower tariffs as approved by the Federal Antimonopoly Agency than those charged to other customers. In addition, the Government may by law require the Company to provide certain services to the Government in connection with national security and the detection of crime.

*(in thousands roubles)*

## 33. Balances and Transactions with Related Parties (continued)

***Transactions with Government Organizations (continued)***

Article 47 of the Federal Law # 126-FZ “On Communications” came into force starting January 1, 2005. Provisions of this article changed previously established pattern of settlements with subscribers for privileges granted for communication services. Under the old pattern the Company issued invoices to the privileged subscribers net of the amount of privilege, which was subsequently reimbursed by the state budget. The new pattern assumes that privileged subscribers pay for the services rendered in full and further receive a reimbursement directly from the state budget.

Government subscribers and tariff compensation accounted for approximately 18% of gross trade accounts receivable as of December 31, 2005 (2004 – 40%). Amounts outstanding from government subscribers and debt of social security organizations with regard to compensation of expenses related to granting privileges to certain category of subscribers, as of December 31, 2005 amounted to 178,029 (2004 – 396,431) (Note 13). Revenues from this category of subscribers are presented in Note 23.

***Transactions with other Related Parties***

***Rendering of Services***

During the years ended December 31, 2005 and 2004 the Company rendered services to the following related parties:

| Related party | Relationship | Type of sales | Price determination method | 2005 | 2004 |
|---|---|---|---|---|---|
| OJSC “Rostelecom” | Svyazinvest Group Company | Telecommunication services | Regulated tariff | 441,917 | 375,039 |
| CJSC “Rostelegraph” | Investee company | Telecommunication services | Regulated tariff | 24,850 | 30,840 |
| CJSC “TeleRoss-Vladivostok” | Associate company | Telecommunication services | Market price | 23,429 | 18,731 |
| Other | | | | 3,824 | 792 |
| **Total** | | | | **494,020** | **425,402** |

*(in thousands roubles)*

## 33. Balances and Transactions with Related Parties (continued)

***Purchases***

During the years ended December 31, 2005 and 2004 the following related parties rendered a significant amount of services to the Company:

| Related party | Relationship | Type of sales | Price determination method | 2005 | 2004 |
|---|---|---|---|---|---|
| OJSC "Rostelecom" | Svyazinvest Group Company | Telecommunication services | Regulated tariff | 1,292,605 | 1,192,592 |
| OJSC "RTKomm.RU" | Svyazinvest Group Company | Telecommunication services | Market price | 151,978 | 103,603 |
| NCP "Center for Research of Problems in Development of Telecommunications" | Svyazinvest Group Company | Agent agreement | Contracted price | 45,873 | 60,500 |
| CJSC "Rostelegraph" | Investee company | Telecommunication services | Regulated tariff | 26,352 | 32,873 |
| LLC "Magalyaskom" | Associate company | Telecommunication services (Rent of channel) | Market price | 6,534 | 4,706 |
| CJSC "Registrator – Svyaz" | Svyazinvest Group Company | Maintenance of shareholders' register | Market price | 1,666 | 1,424 |
| OJSC "Nacionalnaya taksofonnaya set" | Svyazinvest Group Company | Prepaid cards | Market price | 598 | 2,808 |
| Other | | | | 354 | 15,080 |
| **Total** | | | | **1,525,960** | **1,413,586** |

### Settlements with Related Parties

*Accounts Receivable*

As of December 31, 2005 and 2004 significant balances of accounts receivable from related parties were as follows:

| Related party | Relationship | Type of receivables | 2005 | 2004 |
|---|---|---|---|---|
| NCP "Center for Research of Problems in Development of Telecommunications" | Svyazinvest Group Company | Agent agreement<br>Target membership fees | 105,149 | 41,024 |
| OJSC AKB "Svyaz-Bank" | Svyazinvest Group Company | Bank services | 13,663 | 12,380 |
| CJSC "TeleRoss-Vladivostok" | Associate company | Telecommunication services | 2,864 | 3,693 |
| Other | | | 677 | 7,640 |
| **Total** | | | **122,353** | **64,737** |

*(in thousands roubles)*

## 33. Balances and Transactions with Related Parties (continued)

### Settlements with Related Parties (continued)

*Accounts Payable:*

As of December 31, 2005 and 2004 significant balances of accounts payable to related parties were as follows:

| Related party | Relationship | Type of payables | 2005 | 2004 |
|---|---|---|---|---|
| OJSC "Rostelecom" | Svyazinvest Group Company | Telecommunication services | 85,106 | 82,167 |
| NCP "Center for Research of Problems in Development of Telecommunications" | Svyazinvest Group Company | Agent agreement Target membership fees | 20,300 | 30,451 |
| OJSC "RTKomm.RU" | Svyazinvest Group Company | Telecommunication services | 3,116 | 4,102 |
| Other | | | 2,868 | 12,887 |
| **Total** | | | **111,390** | **129,607** |

***OJSC "Svyazinvest"***

The Company's parent entity - OJSC "Svyazinvest" - was wholly owned by the Russian Government until July 1997 when the Government sold 25% plus one share of the Charter Capital of OJSC "Svyazinvest" to the private sector.

An effectively operating telecommunications and data transmission facility is of great importance to Russia for various reasons including economic, strategic and national security considerations. Consequently, the Government has and may be expected to continue to exercise significant influence over the operations of OJSC "Svyazinvest" and its subsidiary companies.

The Government's influence is not confined to its share holdings in OJSC "Svyazinvest". It has general authority to regulate tariffs, including domestic long distance tariffs. In addition, the Ministry of Information Technologies and Communications of the Russian Federation has control over the licensing of providers of telecommunications services.

***OJSC "Rostelecom"***

OJSC "Rostelecom", a majority owned subsidiary of OJSC "Svyazinvest", is the primary provider of domestic long distance and international telecommunications services in the Russian Federation. The annual expense associated with traffic carried by OJSC "Rostelecom" and terminated outside of the Company's network is stated as interconnection charges. Further, OJSC "Rostelecom" uses the Company's network to provide incoming long-distance and international traffic to its subscribers and partner operators. Changes in settlements with OJSC "Rostelecom" after January 1, 2006 are described in Note 35.

## 33. Balances and Transactions with Related Parties (continued)

**Settlements with Related Parties (continued)**

***Non-Commercial Partnership Centre for Research of Problems in Development of Telecommunications***

The non-commercial partnership Centre for Research of the Problems in Development of Telecommunications (hereinafter "the Partnership") is an entity OJSC "Svyazinvest" controls through its subsidiaries. The Company has an agreement with the Partnership under which it provides funding for industry research and common administrative activities on behalf of the Company and other subsidiary and associates of OJSC "Svyazinvest". Payments to the Partnership included in other operating expenses in the accompanying consolidated statement of operations for the year ended December 31, 2005 amounted to 45,873 (2004 – 60,500).

***NPF Telecom-Soyuz***

In 2005 the Company signed new centralized pension agreement with NPF Telecom-Soyuz (see Note 22). OJSC "Svyazinvest" holds the majority in the Board of Directors of NPF Telecom-Soyuz ("the Fund"). Payments from the Company to the Fund in 2005 amounted to 4,850 (2004 – 55,152).

***Compensation to Key Management Personnel***

Key management personnel comprise members of the Management Board and the Board of Directors of the Company, totaling 21 persons as of December 31, 2005 and 2004. Total compensation to key management personnel included in "Other operating expenses, net" in the statement of operations amounted to 37,572 and 33,757 (see Note 24) for the years ended December 31, 2005 and 2004, respectively, and consists of remuneration for management services.

## 34. Financial Instruments and Risk Management Objectives and Policies.

The Company's principal financial instruments comprise bank loans, finance leases, vendor financing, bonds, cash and short-term deposits. The main purpose of these instruments is to raise finance for the Company's operations. The Company has other financial assets and liabilities such as trade receivables and trade payables, which arise directly from its operations.

***Foreign Exchange Risk***

Foreign exchange risk is the risk that fluctuations in exchange rates will adversely affect items in the Company's statement of operations, balance sheet and/or cash flows. Foreign currency denominated liabilities (see Note 18) give rise to foreign exchange exposure.

The Company does not have arrangements to mitigate foreign exchange risks of the Company's operations.

As at December 31, 2005 the Company's liabilities in foreign currency were 270,194 (2004 – 381,540), including liabilities denominated in US dollars 227,825 (2004 – 329,547) and Euro 42,369 (2004 – 51,993).

For the period from December 31, 2004 to December 31, 2005 the exchange rate of the Russian Ruble to the US Dollar decreased by approximately 3.7% and the exchange rate of the Russian Ruble to the Euro decreased by approximately 9.6%. The possible decrease in the exchange rate of the Russian Ruble will lead to an increase in the amount of the Company's borrowings, as well as it may cause difficulties in the attraction of funds including funds required for the refinancing of the existing debt.

*(in thousands roubles)*

**34. Financial Instruments and risk management objectives and policies. (continued)**

***Interest Rate Risk***

Interest rate risk is the risk that changes in market interest rates may negatively impact the Company's financial results.

The Company has no borrowings, which bear floating rates of interest.

The following table presents as of December 31, 2005 and 2004 the carrying amount by maturity of the Company's financial instruments that are exposed to interest rate risk:

| **As of December 31, 2005:** | **< 1 year** | **1–5 years** | **> 5 years** | **Total** |
|---|---|---|---|---|
| *Fixed rate* | | | | |
| Short–term borrowings | 338,596 | – | – | **338,596** |
| Current portion of long–term borrowings | 1,726,362 | | | **1,726,362** |
| Long–term borrowings | – | 725,943 | – | **725,943** |
| Finance lease obligations | 349,791 | 867,626 | – | **1,217,417** |

| **As of December 31, 2004:** | **<1 year** | **1–5 years** | **>5 years** | **Total** |
|---|---|---|---|---|
| *Fixed rate* | | | | |
| Short–term borrowings | 120,373 | – | – | **120,373** |
| Current portion of long–term borrowings | 1,238,521 | – | – | **1,238,521** |
| Long–term borrowings | | 513,219 | | **513,219** |
| Finance lease obligations | 343,262 | 1,063,904 | 630 | **1,407,796** |

Interest on financial instruments classified as fixed rate is fixed until maturity of the instrument. The other financial instruments of the Company that are not included into the above tables are non-interest bearing and are therefore not subject to interest rate risk.

The Company has no significant interest-bearing assets.

***Credit Risk***

Credit risk is the risk that a counter-party will fail to discharge an obligation and cause the Company to incur a financial loss.

Financial assets, which are potentially subject to credit risk, consist principally of trade receivables. The carrying amount of accounts receivable, net of provision for impairment of receivables, represents the maximum amount exposed to credit risk. The Company has no significant concentrations of credit risk due to the significance of the client base and regular monitoring procedures over customers' and other debtors' ability to pay debts. A part of accounts receivable is represented by state and other non-commercial organizations. Recovery of this debt is influenced by political and economic factors. Management believes that as of December 31, 2005 there is no significant risk of loss to the Company beyond the provision already recorded.

The Company places cash on bank accounts in a number of Russian commercial financial institutions. Insurance of bank accounts is not provided by financial institutions operating in Russia. To manage the credit risk the Company places cash in different financial institutions, and the Company's management analyzes the risk of default of these financial institutions on a regular basis.

*(in thousands roubles)*

## 34. Financial Instruments and risk management objectives and policies. (continued)

### *Fair Value*

Fair value of a financial instrument is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction (except for forced sale or liquidation). Market prices are considered to be the best evidence of fair value.

Management believes that the carrying values of financial assets and liabilities approximate their fair values.

| | 2005 | | 2004 | |
|---|---|---|---|---|
| **Financial instruments** | **Carrying Amount** | **Fair value** | **Carrying Amount** | **Fair value** |
| ***Financial Assets*** | | | | |
| Investments in associates | 25,969 | 25,969 | 26,303 | 26,303 |
| Long–term investments available for sale | 7,432 | 7,432 | 3,486 | 3,486 |
| Long–term accounts receivable | 609 | 609 | – | – |
| Long–term borrowings given | 22,545 | 22,545 | 25,305 | 25,305 |
| Accounts receivable | 826,569 | 826,569 | 632,049 | 632,049 |
| Cash and cash equivalents | 158,331 | 158,331 | 129,210 | 129,210 |
| **Total** | **1,041,455** | **1,041,455** | **816,353** | **816,353** |
| ***Financial Liabilities*** | | | | |
| Long–term bank loans | 668,773 | 668,773 | 317,000 | 317,000 |
| Long–term promissory notes | – | – | 166,291 | 166,291 |
| Long–term suppliers' credits | 57,170 | 57,170 | 29,993 | 29,993 |
| Long–term finance lease obligations | 867,626 | 867,626 | 1,064,534 | 1,064,534 |
| Accounts payable | 1,390,968 | 1,390,968 | 1,462,204 | 1,462,204 |
| Short–term bank loans | 274,683 | 274,683 | 101,490 | 101,490 |
| Current portion of long–term bank loans | 176,662 | 176,662 | - | - |
| Current portion of long–term bonds | 1,016,027 | 1,040,000 | 1,018,492 | 1,037,000 |
| Current portion of long–term promissory notes | 512,382 | 512,382 | 216,521 | 216,521 |
| Current portion of long–term suppliers' credits | 85,204 | 85,204 | 22,456 | 22,456 |
| Current portion of long–term finance lease obligations | 349,791 | 349,791 | 343,262 | 343,262 |
| **Total** | **5,399,286** | **5,423,259** | **4,742,113** | **4,760,621** |

## 35. Subsequent Events

### *New provisions of the Federal Law on Communications*

The legislative framework for the reform of the Russian telecommunications industry is the Federal Law on Communications of 2004. To implement the Federal Law on Communications, the Russian Government approved new rules and regulations for the interconnection and interaction of telecommunications networks, for the provision of local, intra-regional, DLD, and ILD telephone services, and other regulations for the provision of long-distance services, including licensing requirements for telecommunications operators. The transition to the new system of interaction on January 1, 2006 stems from these new requirements under the Russian legislation.

New regulations required in pursuance of the Federal Law on Communications come into force starting January 1, 2006:

## 35. Subsequent Events (continued)

***New Provisions of the Federal Law on Communications (continued)***

1. Decision of the government of the Russian federation no. 161 of March 28, 2005 on endorsing the Rules for connecting electric communication networks and for their interaction (with Amendments and Addenda of June 30, December 29, 2005)
2. Decision of the government of the Russian federation no. 310 of May 18, 2005 on the approval of Rules for Rendering Services of Local, Intra-Zone, Inter-City and International Telephone Communication (approved by Decision of the Government of the Russian Federation No. 310 of May 18, 2005) (with the Amendments and Additions of June 30, December 29, 2005).
3. Decision of the government of the Russian federation no. 242 of April 21, 2005 on the approval of the Rules for state regulation of tariffs on universal communications services (with the amendments and additions of October 24, 2005)
4. Order of the Ministry of Communications no. 97 of August 8, 2005 on Approval of the requirements to public switched telephone networks.
5. Order of the Ministry of Communications no. 98 of August 8, 2005 on Approval of the requirements to traffic transmission in public switched telephone networks.

***Changes in Settlements with OJSC "Rostelecom" in 2006***

Prior to January 1, 2006 the Company, in accordance with the terms of its Addendum #1 to license for telecommunication services, rendered domestic long-distance (DLD) and international long-distance (ILD) services ("long-distance services") to its customers. Revenues and receivables from rendering of the services were recognized as the Company's revenues and receivables.

Under the previous system of interaction with operators, OJSC "Rostelecom" provided long-distance traffic transit services to the Company. The Company independently billed for long-distance services provided to its local network subscribers through its own subscriber billing systems. The Company settled with Rostelecom for long-distance call transit and termination services, and Rostelecom, in turn, paid the Company for call termination services. The Company performed settlements for international telecommunications services with subscribers by tariffs, set by OJSC "Rostelecom", and settlements for intercity telecommunications services by tariffs, set by the Federal Antimonopoly Agency.

Starting from 2006 the settlements between the Company and OJSC "Rostelecom" change. Domestic long-distance (DLD) and international long-distance (ILD) services will be rendered by OJSC "Rostelecom". Revenues and receivables from rendering of the services will be recognized as OJSC "Rostelecom" revenues and receivables.

The Company and OJSC "Rostelecom" signed an agreement for the year 2006 combining elements as of an agency agreement as well as of a service contract, according to which the Company undertakes rendering the following services to OJSC "Rostelecom":

- Subscriber orders' processing services for access to intercity and international telecommunications services provided through the direct and delay operations.
- Billing processing services for intercity and international telecommunications services.
- Preparation, formation and storage of necessary data and reports;
- Agency services on collection of payments from subscribers and on call center support in the name and on behalf of OJSC "Rostelecom";
- Claims administration, documents delivery.

## 35. Subsequent Events (continued)

***Changes in Settlements with Rostelecom in 2006 (continued)***

In addition to the above mentioned contract the parties signed the agreement on network interconnections, under which the Company provides OJSC "Rostelecom" the services on traffic transmission and OJSC "Rostelecom" provides the Company connection services.

To comply with the new regulatory requirements, the Company must fulfill a number of conditions, including:

- technical conformity of its network to requirements set for DLD and ILD communication networks, including availability of interconnection points to its network in every federal administrative region of the Russian Federation; and
- operational readiness to provide long-distance services to any local network subscriber.

Fulfillment of these requirements would not lead to additional capital expenditure of the Company as major necessary capital expenditure was made in 2005.

***Changes in Settlements with Interconnected Operators***

New legislative pronouncements effective January 1, 2006 significantly changed the scheme of settlements with interconnected operators.

Prior to January 1, 2006 settlements for interconnection services with the operators for local telephone services were of unilateral nature, and for intra-regional, DLD, and ILD telephone services interconnected operators received a part of the revenues from such services depending on the degree of their participation in the provision of a service.

Starting from January 1, 2006 settlements are of a mutual nature and consist of the following:

- point of connection set up;
- user fee for point of connection;
- fee per minute of traffic submitted through the network.

The changes will result in additional revenues from interconnection and traffic transmission as well as in additional costs related to payments to these operators for connection points set up, user fee and traffic transmission in the operators' network.

**35. Subsequent Events (continued)**

***Significant Operator***

In accordance with Order of the Federal Service for Communications Supervision (Rossvyaznadzor) no. 39 on October 21, 2005, no. 40 and 31 on October 24, 2005 and no. 52 on December 22, 2005 the Company is included into the Register of Communications services operators occupying an important position in the general-use communications network (Significant Operator).

An operator occupying an important position in the general-use communications network, is obliged to establish, for the purposes of ensuring indiscriminate access to the market of communications services under similar circumstances, equal conditions for connecting telecommunications networks and for letting through traffic for communications operators rendering similar services, as well as to supply information and to render connection services and the services involved in letting through the traffic to these operators under the same terms and of the same standard, like for his own structural subdivisions and/or for the affiliated persons.

An operator occupying an important position in the general-use communications network on the territories of several subjects of the Russian Federation shall establish the terms for connecting telecommunications networks and for letting through traffic separately on the territory of each subject of the Russian Federation.

The refusal of an operator occupying an important position in the general-use communications network to conclude a contract for connecting telecommunications networks is seen as inadmissible, with the exception of cases when the connection of the telecommunications networks and their interaction contradict the terms of the licenses issued to communications operators, or the legal normative acts determining the construction and the functioning of the uniform telecommunications network of the Russian Federation.

Prices for connection services and for services involved in letting through traffic rendered by operators occupying an important place in the general-use communications network are subject to state regulation. The list of connection services and services for letting through the traffic, the prices for which are subject to state regulation, as well as the procedure for their regulation, are established by the Government of the Russian Federation.

***Rendering of Universal Telecommunication Service***

Universal communication service is the communication service whose rendering to any user of communication service on the entire territory of the Russian Federation within a fixed term, of the established standard and at a reasonable price is obligatory for operators of the universal servicing. This service is to be rendered by operators of universal servicing who are selected in accordance with the results of a tender or are appointed in accordance with the Federal Law for every subject of the Russian Federation.

In the 4$^{th}$ quarter 2005 the Company was nominated to provide universal telecommunication services using payphones in all Far East regions where it operates. The Company has to start providing these services within 6 months after announcement of the result of the tender as stipulated in respective agreements signed with Federal telecommunication agency.

The agreements authorizing the Company to render universal telecommunication services are effective for five years. According to the agreements the amount to compensate annual losses resulted from rendering such services will not exceed 287,624. Capital expenditures necessary to use to prepare for rendering universal telecommunication services amount to 279,729.

**35. Subsequent Events (continued)**

***Cancellation of Charges for Incoming Calls***

In March 2006 an amendment to the Federal Law on Communication was approved by the President. According to this amendment effective July 1s, 2006 the subscriber will not pay for a telephone connection established as a result of a call by another subscriber, except for the cases specifically mentioned in the Federal Law on Communication.

This change would mainly affect the settlements between the Company and mobile network operators.

Starting from the enforcement of this amendment the Federal Service on Tariffs will set tariffs for intra-regional services between the Company as a significant operator and mobile network operators. Subsequent to that the Company would renegotiate the agreements with these operators.

The Company envisages increase in revenues from intra-regional services in the second half of 2006 and increase in costs related to calls termination on mobile networks.

***Tariffs for Telecommunication Services***

Under Decree of the Government of the Russian Federation # 627 dated October 19, 2005 settlement rates (including rates for call origination, termination, and transit) for operators occupying a significant position in the public communications network (significant operators) are regulated by the Federal Service for Communications Supervision (Rossvyaznadzor) under the supervision of the Federal Tariff Service (FST) in accordance with the Federal Law on Natural Monopolies.

In November 2005 the Company submitted its proposed tariffs to Rossvyaznadzor for approval. The tariffs were determined based on the 2005 rates. Due to the absence of unified methodology on determination of economically justifiable costs the tariffs were not approved by the supervising body. Prior to setting such tariffs by the Federal Service for Communications Supervision the Company is allowed to determine these tariffs independently.

In December 2005 the Federal Service for Communications Supervision determined the amount of the compensation surcharge to be included in rates for call origination services provided by the Company as a significant operator. The surcharge is set at 0.78 Roubles per minute and is effective starting January 1, 2006. The compensation surcharge is supposed to cover the difference between an operator’s income and economically justified costs in providing local and intra-regional communication services.

***Impact of new rules for Rendering of Telecommunication Services on Financial Statements***

The Company’s management expects that new rules of provision of telecommunication services will influence both revenues and expenses of the Company, however, the Company cannot reliably measure the effect of such changes on the financial position and financial results of the Company.

***Value Added Tax***

Federal Law No. 119-FZ dated July 22, 2005, introduced amendments to the Tax Code effective January 1, 2006. According to these amended provisions VAT taxable base on sales of goods (rendering of services) is determined at the earliest of:

- date of goods (services) shipment (rendering);
- date of payment (partial payment) for subsequent delivery of goods (services), transfer of rights of ownership.

## 35. Subsequent Events (continued)

***Purchase of Share in OJSC "National Television Company "Zvezda"***

In January 2006 the Company purchases 350 ordinary shares of National television company "Zvezda" for 47,410. The purchase was approved by the Board of Directors decision dated January 18, 2006. Total share of the Company in the investee amounted to 1.665%.

***Dividends***

In June, 2006 the general meeting of the Company's shareholders approved dividends for 2005 in the amount of 2.69 Rouble per preference share and 0.90 Rouble per ordinary share. Total dividends declared amounted to 169,867 (2004 – 227,217). Dividends for the year ended December 31, 2005, are payable during 2006 and will be accrued in the financial statements for the year ended December 31, 2006 (see also Note 30 "Dividends Declared and Proposed for Distribution").

***Employee Redundancy Program***

In accordance with the Employee Redundancy Program approved by the Company's Management Board on December 26, 2005 the Company dismissed 857 employees paying compensation totaling 16,551 between December 31, 2005 and the date of the authorization of the financial statements for the issue.

***Bonds Issue***

On June 07, 2006 the Company issued 2,000,000 interest-bearing bonds, par value 1,000 Roubles each. The bonds have 12 half-year coupons. The bonds mature as follows: 15% of par value on 1,274$^{th}$ day, 15% of par value on 1,456$^{th}$ day, 15% of par value on 1,638$^{th}$ day, 15% of par value on 1,820$^{th}$ day, 20% of par value on 2,002$^{nd}$ day, and 20% of par value on 2,184$^{th}$ day starting from the date of issue. The early redemption option can be used after 3 years. The interest rate was determined at the level of 8.85%.

On June 07, 2006 the Company issued 1,500,000 interest-bearing bonds, par value 1,000 Roubles each. The bonds have 6 half-year coupons. The bonds mature as follows: 20% of par value on 546$^{th}$ day, 20% of par value on 728$^{th}$ day, 30% of par value on 910$^{th}$ day, and 30% of par value on 1,092$^{nd}$ day starting from the date of issue. The interest rate was determined at the level of 8.60%.

The Company used proceeds received from the bonds issued to refinance previously received short-term and long term loans and borrowings in total amount of 1,836, 985.

***Finance Leasing Agreements***

In 2006 the Company entered into several finance lease agreements. Total delivery cost of equipment leased under these agreements, inclusive of installation and other capitalized services, approximated 12,442, with respective non-discounted future minimum lease payments totaling approximately 17,584.