OAO “Southern Telecommunications Company”

Consolidated Financial Statements

Year ended December 31, 2003

with Report of Independent Auditors

OAO "Southern Telecommunications Company"

Consolidated Financial Statements

Year ended December 31, 2003

with Report of Independent Auditors

Contents

Independent Auditors' Report

To the Shareholders and Board of Directors
of OAO "Southern Telecommunications Company"

1. We have audited the accompanying consolidated balance sheet of OAO "Southern Telecommunications Company" (a Russian open joint-stock company - hereinafter "the Company"), as of December 31, 2003, 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. We conducted our audit in accordance with International Standards on Auditing issued by the International Federation of Accountants. These 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 28 "Pension Plans and Employee Benefits", the Company has not determined and presented its obligations existing under defined benefits plans in accordance with IAS 19, "Employee Benefits". We were not able to quantify the adjustments to the financial statements required to properly present the following items: (i) assets and liabilities under defined benefit plans, deferred income taxes and retained earnings as of December 31, 2003 and the related amounts of wages, salaries, other benefits and payroll taxes, income tax expense and net income for the year ended December 31, 2003, (ii) the related disclosures and (iii) the corresponding amounts for 2002. This matter also resulted in the qualification of our audit opinion on the consolidated financial statements for the year ended December 31, 2002.

4. As described in Note 11 "Property, Plant and Equipment", the Company's accounting records relating to fixed assets are not designed to support their presentation in accordance with IAS 16, "Property, Plant and Equipment", IAS 29, "Financial Reporting in Hyperinflationary Economies" and IAS 36, "Impairment of Assets". As such, certain estimates were made by management to present fixed assets in the accompanying financial statements. Owing to the nature of the Company's records, we were unable to determine the adjustments to the financial statements required to properly present the following items (i) property, plant and equipment, deferred revenue, deferred income taxes and retained earnings as of December 31, 2003 and the related amounts of depreciation expense, income tax expense and net income for the year ended December 31, 2003, (ii) the related disclosures and (iii) the corresponding amounts for 2002. This matter caused us to similarly qualify our audit opinion on the consolidated financial statements for the year ended December 31, 2002.

5. In our opinion, except for the effects on the financial statements of the matters referred to in paragraphs 3 and 4, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of OAO "Southern Telecommunications Company" as of December 31, 2003, and the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

6. Without further qualifying our opinion, we draw attention to Note 1 in the financial statements, which indicates that as of December 31, 2003 current liabilities of OAO "Southern Telecommunications Company" exceeded its current assets by 5,752,775 thousand rubles. This condition, as set forth in Note 1, indicates the existence of a material uncertainty, which may cast significant doubt about the Company's ability to continue as a going concern.

7. Without further qualifying our opinion, we draw attention to Note 1 in the financial statements which discloses that the Company was the subject of a reorganization that was approved by the meeting of shareholders on December 21, 2001. The Company has accounted for the merger based on the principles of uniting of interests as described in IAS 22, "Business Combinations". In applying this method, the Company has reflected amounts in the financial statements as if the entities had been combined as of January 1, 2002 (the earliest period presented).

October 8, 2004

OAO "Southern Telecommunications Company"

Consolidated Balance Sheet

As of December 31, 2003

(in thousand rubles)

	Notes	December 31, 2003	December 31, 2002 as restated (see Note 2)
ASSETS			
Non-current assets:			
Property, plant and equipment, net	11	**23,746,853**	16,496,257
Intangible assets, net	12	**583,724**	6,638
Long-term investments in associates	14	**409,404**	511,690
Financial investments and other long-term assets	15	**85,138**	267,503
Advances to suppliers of equipment	17	**499,076**	172,490
Total non-current assets		**25,324,195**	17,454,578
Current assets:			
Inventories, net	18	**998,253**	658,333
Accounts receivable, net	19	**790,636**	900,986
Other current assets, net	20	**1,849,998**	568,014
Cash and cash equivalents	21	**404,113**	229,920
Total current assets		**4,043,000**	2,357,253
TOTAL ASSETS		**29,367,195**	19,811,831
SHAREHOLDERS' EQUITY AND LIABILITIES			
Shareholders' equity:			
Preference shares	22	**320,810**	320,810
Ordinary shares	22	**976,969**	976,969
Inflation impact on share capital		**1,741,475**	1,741,475
Retained earnings and other reserves		**8,844,748**	9,163,237
Total shareholders' equity		**11,884,002**	12,202,491
Commitments and contingencies	28	–	–
Minority interest in subsidiaries	23	**181,909**	148,539
Non-current liabilities:			
Loans and borrowings	24	**4,968,908**	999,609
Finance lease obligations	25	**1,710,467**	225,659
Deferred revenue		**385,871**	340,031
Deferred income tax liability	8	**385,240**	820,436
Other non-current liabilities		**55,023**	36,203
Total non-current liabilities		**7,505,509**	2,421,938
Current liabilities:			
Accounts payable and accrued liabilities	26	**2,450,560**	1,305,189
Payables to Rostelecom	30	**245,090**	227,650
Taxes and payroll related obligations	27	**421,605**	516,900
Dividends payable	10	**141,290**	204,853
Short-term loans and borrowings	24	**4,510,603**	1,227,365
Current portion of loans and borrowings	24	**1,406,833**	1,406,137
Current portion of finance lease obligations	25	**619,794**	112,901
Reserves	16	–	37,868
Total current liabilities		**9,795,775**	5,038,863
Total shareholders' equity and liabilities		**29,367,195**	19,811,831

General Director
__________ I.F.Ignatenko

Chief Accountant
___________ T.V.Rusinova

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

OAO "Southern Telecommunications Company"

Consolidated Statement of Operations

For the year ended December 31, 2003

(in thousands, except share and per share amounts)

	Notes	2003	2002 as restated (see Note 2)
Revenues	**4**	**13,966,062**	11,894,277
Operating expenses			
Wages, salaries, other benefits and payroll taxes		**(4,941,276)**	(4,190,506)
Depreciation and amortization		**(2,489,831)**	(2,457,100)
Interconnection charges		**(1,918,912)**	(1,672,156)
Materials, repairs and maintenance, utilities		**(1,588,349)**	(1,262,194)
Taxes other than income tax		**(289,313)**	(333,627)
Bad debt expense		**(224,807)**	(127,079)
Loss on disposal of property, plant and equipment		**(52,451)**	(25,726)
Other operating expenses	**5**	**(1,342,875)**	(1,197,258)
Total operating expenses		**(12,847,814)**	(11,265,646)
Operating income		**1,118,248**	628,631
Income from associates		**85,440**	271,507
Interest expenses, net	**6**	**(638,842)**	(342,188)
Income from long-term investments		**388,379**	1,189,452
Other expenses, net	**7**	**(228,289)**	(80,752)
Foreign exchange loss, net		**(172,558)**	(321,278)
Net monetary gain		**–**	466,536
Income before taxation and minority interest		**552,378**	1,811,908
Income tax expense	**8**	**(217,225)**	(894,476)
Income before minority interest		**335,153**	917,432
Minority interest	**23**	**(188,555)**	(94,309)
Net income		**146,598**	823,123
Dividends on preference shares	**10**	**(156,225)**	(147,401)
Income (loss) attributable to ordinary shareholders		**(9,627)**	675,722
Basic and diluted earnings (loss) per share (Russian Rubles)	**9**	**(0.003)**	0.23

General Director

__________ I.F.Ignatenko

Chief Accountant

___________ T.V.Rusinova

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

OAO “Southern Telecommunications Company”

Consolidated Statement of Cash Flows

For the year ended December 31, 2003

(in thousands, except share and per share amounts)

	2003	**2002 as restated (Note 2)**
Cash flows from operating activities:		
Income before taxation and minority interest	**552,378**	1,811,908
Adjustments to reconcile income (loss) to cash generated from operations:		
Income from investments	**(388,379)**	(1,189,452)
Income from investments in associates	**(85,440)**	(271,507)
Depreciation and amortization	**2,489,831**	2,457,100
Interest expense, net	**638,842**	342,188
Bad debt expense	**224,807**	127,079
Foreign currency exchange loss, net	**172,558**	321,278
Loss on disposal of property, plant and equipment	**52,451**	25,726
Inventory impairment provision	**4,218**	12,594
Net monetary gain	–	(466,536)
Operating profit before changes in working capital:	**3,661,266**	3,170,378
Increase in other current assets	**(1,270,637)**	(112,529)
Increase in inventories	**(344,140)**	(290,305)
Increase in trade accounts receivable	**(114,457)**	(301,160)
(Decrease) increase in taxes and payroll related obligations	**(13,561)**	153,887
Increase in accounts payable and accrued liabilities	**889,488**	253,347
Cash flows generated from operations:	**2,807,959**	2,873,618
Interest paid	**(686,695)**	(225,922)
Income tax paid	**(668,806)**	(766,447)
Net cash flows provided by operating activities	**1,452,458**	1,881,249
Cash flows from investing activities:		
Purchase of property, plant and equipment and assets under construction	**(7,256,678)**	(2,502,780)
Purchase of intangible assets	**(584,837)**	–
Proceeds from sales of investments and other financial assets	**556,706**	1,306,196
Proceeds from sales of property, plant and equipment and assets under construction	**29,132**	139,251
Dividends received	**10,862**	13,562
Interest received	**10,452**	6,919
Net cash flows used in investing activities	**(7,234,363)**	(1,036,852)

(in thousands, except share and per share amounts)

	2003	2002 as restated (Note 2)
Net cash flows provided by operating activities (from previous page)	**1,452,458**	1,881,249
Net cash flows used in investing activities (from previous page)	**(7,234,363)**	(1,036,852)
Net cash flows from (used in) financing activities:		
Repayment of borrowings	**(2,228,585)**	(1,462,239)
Repayment of vendor financing obligations	**(648,464)**	(567,060)
Repayment of finance lease obligations	**(327,805)**	(171,853)
Dividends paid	**(460,183)**	(312,558)
Dividends paid to minority interest	**(155,185)**	–
Receipt of borrowings	**8,259,462**	1,697,971
Proceeds from debt securities issued	**1,500,000**	–
Proceeds from other non-current liabilities	**16,906**	–
Net cash flows from (used in) financing activities	**5,956,146**	(815,739)
Monetary effects on cash and cash equivalents	**–**	(49,885)
Effects of exchange rate changes on cash and cash equivalents	**(48)**	(115)
Increase (decrease) in cash and cash equivalents	**174,193**	(21,342)
Cash and cash equivalents at the beginning of the year	**229,920**	251,262
Cash and cash equivalents at the end of the year	**404,113**	229,920
Non-monetary operations:		
Property, plant and equipment acquired through vendor financing	**608,910**	979,219
Property, plant and equipment acquired under lease agreements	**2,319,506**	385,678
Equipment contributions	**51,497**	71,073

General Director ___________ I.F.Ignatenko

Chief Accountant ___________ T.V.Rusinova

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

OAO “Southern Telecommunications Company”

Consolidated Statement of Changes in Shareholders’ Equity

For the year ended December 31, 2003

(in thousands, except share and per share amounts)

	Notes	Share capital: Preference shares	Share capital: Ordinary shares	Inflation impact on share capital	Retained earnings	Total shareholders’ equity
At December 31, 2001 as restated (see Note 2)	**2**	320,810	976,969	1,741,475	8,730,903	11,770,157
Net income for the year as restated (Note 2)		–	–	–	823,123	823,123
Dividends	**10**	–	–	–	(459,257)	(459,257)
Change in fair value of available-for-sale financial investments		–	–	–	68,468	68,468
At December 31, 2002		320,810	976,969	1,741,475	9,163,237	12,202,491
Net income for the year		**–**	**–**	**–**	**146,598**	**146,598**
Dividends	**10**	**–**	**–**	**–**	**(396,619)**	**(396,619)**
Disposal of available-for-sale financial investments		**–**	**–**	**–**	**(68,468)**	**(68,468)**
At December 31, 2003		**320,810**	**976,969**	**1,741,475**	**8,844,748**	**11,884,002**

General Director

__________ I.F.Ignatenko

Chief Accountant

___________ T.V.Rusinova

(in thousands, except share and per share amounts)

1. General Information

Authorization of Accounts

The consolidated financial statements of OAO “Southern Telecommunications Company” and its subsidiaries – (hereinafter “the Company” or “Southern Telecommunications Company”) for the year ended December 31, 2003 were authorized for issue by its appointed General Director and Chief Accountant on October 8, 2004.

The Company

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

Open joint-stock company Svyazinvest, a holding company majority-owned by the Russian Federation, owns 51% of the Company’s voting shares as of December 31, 2003.

The Company’s principal activities are providing telephone services (including local, long-distance and international calls), telegraph, data transfer services, telematics services rent of channels and wireless communication services on the territory of ten regions of the Southern federal district of the Russian Federation.

Long-distance and international telephone services are provided by OAO “Rostelecom”, a subsidiary of OAO “Svyazinvest”.

The average number of employees in the Company in 2003 was approximately 44 thousand persons (in 2002 – approximately 45 thousand persons).

The registered office of the Company is in the city of Krasnodar (the Russian Federation), 66 Karasunskaya st., 350000.

2002 Reorganization

In 2001 the Company's management started the Company’s reorganization by obtaining shareholder approval to merge the following regional enterprises of OAO “Svyazinvest” wherein 1,810,243 ordinary and 588,730 preferred shares of the Company were exchanged for 100% of the voting and preference shares of the regional enterprises as follows:

Regional enterprise	Ordinary shares issued by the Company	Preferred shares issued by the Company	Exchange ratio
OAO “Elektrosvyaz of Adygei Republic”	44,026,676	–	45.9300
OAO “Svyazinform” of Astrakhan Region	148,513,485	49,503,645	4.5900
OAO “Volgogradelektrosvyaz”	502,266,342	167,422,099	17.7200
OAO “KabBalktelecom”	61,416,990	20,471,554	0.7000
OAO “Electrosvyaz of Kalmykia Republic”	21,114,547	7,038,243	60.4600
OAO “Karachaevo-Cherkesskelektrosvyaz”	14,714,885	4,904,976	17.7297
OAO “Rostovelektrosvyaz”	642,567,217	214,189,311	8.8700
OAO “Sevosetinelektrosvyaz”	123,680,792	41,219,624	8.0000
OAO “Elektrosvyaz of Stavropol Territory”	251,943,205	83,981,261	82.9000
Total	**1,810,244,139**	**588,730,713**	

1. General Information (continued)

2002 Reorganization (continued)

The merger was completed on November 1, 2002. Reorganization costs amounting to 55,448 were expensed in 2002.

The Company accounted for the merger based on the principles of uniting of interests as described in IAS 22, “Business Combinations”. In applying this method, the Company reflected amounts in the financial statements at their historical carrying value as if the entities had been combined at January 1, 2002, the earliest period reported.

Liquidity and Going Concern

As of December 31, 2003 and 2002, the Company's current liabilities exceeded its current assets by 5,752,775 and 2,681,610, respectively. Subsequent to December 31, 2003, the Company has continued to increase its borrowings to finance its capital expenditure program. These borrowings have included ruble bonds that contain options that allow the bondholder to put the bonds to the Company at specified dates within 12 months of this report. The earliest option date could require the Company to redeem 1.5 billion rubles of bonds in February 2005. If bondholders were to exercise their rights under the early redemption options, the Company would need to immediately seek additional financing to meet these obligations. As a result, the Company is significantly dependent on the general stability of the Russian financial markets. Further, the Company’s liquidity is significantly influenced by the continued willingness of a limited number of financial institutions to provide short and long-term financing. As a result of these conditions, the Company’s S&P Russian national scale rating was downgraded in October 2004 to “ruBBB-” from “ruBBB”.

In an effort to address the Company’s liquidity position, management has developed a detailed plan. The main points of this plan include:

- cease the funding of the telecommunication network capital expansion program with short term financing;
- initiate discussions with financial institutions to restructure certain existing short term financing and lease agreements;
- increase, to the extent allowed by regulation, tariffs for services provided. Tariffs increase was partly introduced in August 2004 (see Note 32, “Subsequent Events”);
- continue to dispose of non-core businesses and investments;
- significant scaledown of the investment program by limiting the maximum amounts of capital investments and redistribution of capital expenditures to the sector of more profitable and high-yielding services (“New services”);
- continue to focus on cost reduction.

In addition, management anticipates cash to be generated from operations, further placement of ruble bonds in 2004, and financing from domestic lending institutions.

1. General Information (continued)

Liquidity and Going Concern (continued)

While management believes that its plans can be successfully implemented, there is no assurance that financial conditions within Russia, the Russian financial markets, or the telecommunications sector will not change. In addition, further changes could occur in the sentiment of rating agencies and investors toward the Company. Adverse changes could have a significant impact on the Company and its ability to continue as a going concern

The accompanying financial statements have been presented on the assumption that the Company will continue normal economic activity in the foreseeable future, 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 that might result should 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.

2. Summary of Significant Accounting Policies

Basis of Preparation

The Company maintains its accounting records and prepares its statutory accounting reports in Russian Rubles and in accordance with the Regulations on Accounting and Reporting in the Russian Federation. The accompanying consolidated financial statements presented in accordance with International Financial Reporting Standards (IFRS) are based upon the statutory accounting records that are maintained in accordance with the Russian accounting regulations under the historical cost convention. These statutory accounting records have been adjusted and reclassified to present the accompanying consolidated financial statements in accordance with IFRS, except for accounting of property, plant and equipment (Note 11) and accounting of pension plans and employee benefits (Note 28).

Management Estimates

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

Prior Period Adjustments and Reclassifications

Management of the Company has restated the results for the year ended December 31, 2002 for previously unrecorded adjustments. These adjustments primarily relate to accrual of interconnection costs (these amounts had previously been reflected in the periods invoiced) and related deferred tax effects. In 2003 as a result of improvement of accounting records related to property, plant and equipment, the Company was able to determine more accurate cost of certain equipment, and precisely calculate the related deferred tax. The Company adjusted accordingly the balance sheet as of December 31, 2002 and the results for the year then ended.

(in thousands, except share and per share amounts)

2. Summary of Significant Accounting Policies (continued)

Prior Period Adjustments and Reclassifications (continued)

The effect of these adjustments reflected on previously reported amounts is as follows:

	As previously reported in 2002	**As restated**
Shareholders' equity, January 1, 2002	11,749,070	11,770,157
Net income	1,046,116	823,123
Shareholders' equity, December 31, 2002	12,404,397	12,202,491
Basic and diluted earnings per share	0.30	0.23

Certain amounts in the prior period consolidated financial statements have been reclassified to conform to the current year presentation.

Basis of Consolidation

The consolidated financial statements comprise the financial statements of the Company and its subsidiaries drawn up to December 31, 2003 and 2002.

The Company has accounted for the reorganization (see Note 1 "General Information") based on the principles of uniting of interests as described in IAS 22 "Business Combinations".

Subsidiaries

A subsidiary is an entity that is controlled by the Company, directly or indirectly, generally through ownership of more than 50% of the voting share capital of the entity. These consolidated financial statements include the assets and liabilities, and revenues and expenses of the Company and of subsidiary undertakings, on a line-by-line basis.

Subsidiaries are consolidated from the moment they are actually transferred under control of the Company and are excluded from the consolidated financial statements the moment the control is lost. Where subsidiaries are not controlled throughout the year, consolidated results include the results of those entities for that part of the year during which control existed, except where the Company has applied the uniting of interests method in accordance with IAS 22 "Business Combination". Under the uniting of interests method, the financial statement items of the combining entities are included in the consolidated financial statements as if they had been combined from the beginning of the first period presented.

Where the purchase method is applied to account for the acquisition of subsidiaries, identifiable assets and liabilities of subsidiaries are stated at their fair value as of the acquisition date. Minority interest at the date of acquisition is determined in proportion to minority shareholders' share in the fair value of the assets and liabilities of the subsidiary at that date. The share of minority shareholders is estimated on the basis of the common voting shares and preferred shares owned by shareholders that do not exercise control over the subsidiary.

2. Summary of Significant Accounting Policies (continued)

Subsidiaries (continued)

Balances and transactions between the Company and subsidiary, as well as any income from intercompany transactions are eliminated. Income (loss) from intercompany transactions is identified and eliminated only in cases where the assets transferred under relevant transactions have not been sold to third parties (i.e. non-Company entities) and are carried in the balance sheet of a Company entity as of the balance sheet date.

Associates

An associate is an entity in which the Company has significant influence, but not control, which is usually demonstrated by the Company owning between 20% and 50% of the voting share capital.

Under the equity method, the investments in associates are carried in the balance sheet at cost plus post-acquisition changes in the Company's share of net assets of the associates, less any impairment in value. The income statement reflects the Company's share of the results of operations of the associates.

Unrealized gains and losses arising from transactions with associates are eliminated in proportion to the Company's interest in the associates by adjusting the book value of investments.

Joint Activities

The Company's investments in joint ventures are accounted for using the proportional consolidation method under which interests in joint venture assets, liabilities, income and expenses are included in the relevant items of the consolidated financial statements on a line-by-line basis.

Accounting for the Effects of Inflation

In 2000 – 2002 the Russian Federation met the definition of a hyperinflationary economy, as defined by International Accounting Standard 29 "Financial Reporting in Hyperinflationary Economies" (IAS 29). The inflation rate based on the Russian consumer price index ("CPI"), as calculated by the State Committee on Statistics (Goscomstat), was 15.1% for 2002 (18.6% and 20.2% for 2001 and 2000, respectively). Although the cumulative inflation index for the three-year period ended in 2002 was less than 100%, it was considered that the remaining criteria set forth by IAS 29 indicated that the Russian Federation continued to experience conditions that meet the definition of a hyperinflationary economy during 2002.

IAS 29 requires that financial statements prepared in the currency of a hyperinflationary economy be stated in terms of the measuring unit current at the balance sheet date. In applying IAS 29, the Company used conversion factors derived from the Russian CPI.

(in thousands, except share and per share amounts)

2. Summary of Significant Accounting Policies (continued)

Accounting for the Effects of Inflation (continued)

The indices used to adjust amounts in these consolidated financial statements with respect to 2002 prices (2002 = 1.0) for the years ended December 31, and the respective conversion factors, are:

Year	Index	Conversion factor
1992	7,541	362.4
1993	67,846	40.3
1994	211,612	12.9
1995	487,575	5.6
1996	594,110	4.6
1997	659,403	4.1
1998	1,216,401	2.2
1999	1,663,091	1.6
2000	1,997,843	1.4
2001	2,374,037	1.2
2002	2,733,087	1.0

The main guidelines followed in adjusting the consolidated financial statements as of December 31, 2002 to current purchasing power at December 31, 2002 are:

- all amounts are stated in terms of the measuring unit current at December 31, 2002;
- monetary assets and liabilities are not restated as they are already expressed in terms of the measuring unit current at December 31, 2002;
- non-monetary assets and liabilities which are not carried at amounts current at December 31, 2002 and shareholders’ equity are restated by applying the relevant conversion factors;
- indexation adjustments to property, plant and equipment applicable to prior periods are credited to “Retained earnings and other reserves” in the accompanying balance sheet;
- all items in the consolidated statements of income and of cash flows are adjusted by applying appropriate conversion factors with the exception of depreciation, amortization and losses from disposal of fixed assets and other assets;
- the effect of inflation on the Company’s net monetary position is included in the consolidated statement of operations as a monetary gain.

Effective from January 1, 2003, international accounting and financial reporting bodies have determined that the Russian Federation no longer meets the criteria of IAS 29 for hyperinflation. Beginning 2003, the Company ceased applying IAS 29 and only recognizes the cumulative impact of inflation indexing through December 31, 2002, on non-monetary assets and liabilities. Transactions undertaken subsequent to December 31, 2002 are reported at actual, nominal amounts except for those involving non-monetary assets and liabilities acquired prior to January 1, 2003. Results of operations (including gains and losses on disposal) involving such assets and liabilities are recognized based on the “restated cost”, which was calculated by applying through December 31, 2002 the relevant conversion factors to the carrying values of these assets and liabilities.

(in thousands, except share and per share amounts)

2. Summary of Significant Accounting Policies (continued)

Foreign Currency Transactions

Monetary assets and liabilities denominated in foreign currency are translated into Rubles at official Central Bank of the Russian Federation (CBR) exchange rates at the year-end. Transactions denominated in foreign currencies are reported at the CBR rates of exchange at the date of the transaction. Any gains or losses on assets and liabilities denominated in foreign currencies arising from a change in official exchange rates after the date of transaction are recognized as currency translation gains or losses.

Transactions that are conducted in Rubles when the related assets and liabilities are denominated in foreign currencies (or conventional units) are recorded in the Company’s consolidated financial statements on the same principles as transactions denominated in foreign currencies.

Property, Plant and Equipment

Property, plant and equipment are recorded at purchase or construction cost less accumulated depreciation and any impairment in value, except as disclosed in Note 11, “Property, Plant and Equipment”.

Property, plant and equipment are depreciated on a straight-line basis over the estimated useful lives of each group of assets as follows:

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

For the purpose of disclosure, Property, Plant and Equipment are aggregated into the following groups:

- Buildings and constructions;
- Switches and transmission devices;
- Machines and other assets, in which computers, vehicles and other items are included.

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. 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.

Construction in progress is recorded as the total of actual expenses incurred by the Company from the beginning of construction to the reporting date, adjusted for the effect of inflation (for periods prior to January 1, 2003) from the date when such expenses occur to the reporting date in accordance with IAS 29. Accrual of depreciation begins when fixed assets are put into operation.

2. Summary of Significant Accounting Policies (continued)

Property, Plant and Equipment (continued)

Borrowing costs that are attributable to the acquisition or construction of fixed assets are capitalized as part of the cost of the related asset when it is probable that they will result in future economic benefits to the Company and the costs can be measured reliably. Capitalization of borrowing costs commences with the beginning of activities to prepare the asset for intended use and lasts until the assets are ready for their intended use.

IAS 36, "Impairment of Assets" (IAS 36) stipulates the need to estimate the recoverable amount of assets, including fixed assets, when indicators of impairment exist.

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. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate cash flows, the recoverable amount is determined for the cash-generating unit to which the asset belongs. Impairment losses are recognized in the statement of operations.

In 1998 Russia experienced a severe economic crisis, which was characterized by sharply reduced economic activity, illiquidity, highly volatile foreign-currency-exchange and interest rates, and an unstable stock market. As a result, management assessed the recoverability of property, plant and equipment at December 31, 1998. Based upon this assessment, management recorded an impairment provision related to fixed assets at December 31, 1998. At each balance sheet date management reassess the adequacy of the impairment provision. No further adjustments to impairment provision were made as management believes that subsequent to 1998 there are no impairment indicators exist and fixed assets purchased or constructed after December 31, 1998 will be recovered from their future use.

The cost of maintenance, repairs, and replacement of minor items of fixed assets is charged to maintenance expense. Renewals and betterments are capitalized. Upon the sale or retirement of property, plant and equipment, the cost and related accumulated depreciation are eliminated from the accounts. Any resulting gains or losses are included in the determination of net income.

Deferred Revenue

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, and a corresponding deferred income is recognized in the balance sheet and credited to the statement of operations on the same basis as equipment depreciation.

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

2. Summary of Significant Accounting Policies (continued)

Intangible Assets

Intangible assets are capitalized at cost.

Licenses and software are depreciated on a straight-line basis over the estimated useful life equal to the term of license or of the right to use the software. Useful life of other intangible assets is 5-10 years.

The carrying values of intangible assets are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

Investments

Financial investments include the following three categories: held-to-maturity investments, investments available-for-sale and investments held for trading.

All investments are initially recognized at cost, being the fair value of the consideration given and including acquisition charges associated with the investment.

After initial recognition, investments that are classified as held for trading are measured at their fair value. Gains or losses on reassessment of fair value of investments available for sale are recognized in the income statement and included into income (loss) from financial investments.

Investments that are intended to be held to maturity are measured at amortized historical cost using the effective interest rate method. Amortized cost is calculated by taking into account any discount or premium on acquisition, over the period to maturity. For investments carried at amortized cost, gains and losses are recognized in income when the investments are derecognized or impaired, as well as through the amortization process. Those that do not have a fixed maturity are measured at cost.

Investments that are classified as available-for-sale are measured at their fair value. Gains or losses on available-for-sale investments are recognized as a separate component of equity until the investment is sold, collected or otherwise disposed of, or until the investment is determined to be impaired, at which time the cumulative gain or loss previously reported in equity is included in income.

Other Financial Assets

Other Financial Assets consist of Long-term Accounts Receivable, Long-term Loans Granted to personnel and other financial assets. They are accounted at amortized cost using the effective interest rate. The Company regularly assesses whether there is an objective evidence exist that a financial asset is impaired, at which point it is written down to the recoverable value.

2. Summary of Significant Accounting Policies (continued)

Inventories

Inventories are priced at the lower of cost or net realizable value. Cost is determined using the average cost method.

Transportation, insurance and other similar expenditures incurred to bring inventories to their existing condition and storage location are included into the cost of raw materials and goods for resale.

Accounts Receivable

Accounts receivable are stated at face value, less an allowance for doubtful accounts. A doubtful debts provision is made when collection of the full amount is no longer probable.

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.

Loans and Borrowings Bearing Market Rates of Interest

All interest-bearing loans and borrowings are initially recognized at cost of consideration received. After initial recognition, interest-bearing loans and borrowings are subsequently measured at cost plus accrued interest calculated using the effective interest rate method.

Loans and Borrowings at Non-Market Rates of Interest

The initial recognition of low interest or non-interest bearing loans and borrowings (including vendor financing) received under non-interest-bearing loan agreements are made at their fair market value estimated by discounting future payments at market rates of interest to their present value. Market interest rates are approximated by using the prevailing rates of return for the Company’s financial instruments having substantially the same terms and characteristics. The subsequent measurement of loans and borrowings is carried at amortized cost using the effective interest rate method.

Provisions

Provisions are recognized when the Company has present obligations (legal or constructive) as a result of a past event; settlement of the obligation may require an outflow of resources embodying economic benefits and a reliable estimate can be made of the amount of these obligations. Where the Company expects a provision to be reimbursed, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain. If the effect of the 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 an interest expense.

2. Summary of Significant Accounting Policies (continued)

Pensions and Other Post-Employment Benefits

State Pension Fund

Social contributions are made through a unified social tax ("UST") calculated by the Company by the application of a regressive rate (from 35.6% to 32.5%) to the annual gross remuneration of each employee. The Company allocates the UST to three social funds (state pension fund, social and medical insurance funds), where the rate of contributions to the pension fund vary from 28% to 14% depending on the annual gross salary of each employee.

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

Other pension and post-retirement benefits

Under collective bargaining agreements, the Company also provides pension benefits by means of post-employment retirement benefits. The majority of the Company's employees are eligible to participate under defined benefit plans based upon a number of factors, including years of service, age and compensation.

Post-employment retirement benefits plans may be divided into two types: using defined contribution plans and defined benefit plans.

A defined contribution plan is a post-employment benefit plan under which the Company's liability is limited solely to the amount of a contribution it agrees to pay into a fund. In this case all actuarial and investment risks will be borne by employees. The Company recognizes contributions under a defined contribution plan in the period to which they are attributable.

Under defined benefit plans, the Company's obligation is to provide the agreed benefits to current and former employees whereby actuarial and investment risks fall, in essence, on the Company.

The Company has not made an actuarial determination of its obligations and hence has not recorded its obligations or made disclosures required under IAS 19, "Employee Benefits".

Leases

Finance leases of equipment that transfer substantially all the risks and rewards incidental to ownership of the leased item to the Company are capitalized at the inception of the lease at the market value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged to interest expense.

Capitalized leased assets are depreciated using the straight-line method over the estimated useful life of the asset like other fixed assets within the same class, with consideration of the contractual terms under which the assets can be used.

2. Summary of Significant Accounting Policies (continued)

Leases (continued)

Leases where the lessor retains substantially all the risks and rewards of ownership of the asset are classified as operating leases. Operating lease payments are recognized as an expense in the statement of operations on a straight-line basis over the lease term.

Revenue

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.

The Company categorizes the revenue sources in twelve major categories:

1. Long distance telephone services - domestic;
2. Long distance telephone services - international;
3. Local telephone services;
4. Fees for connecting to telephone network;
5. Documentary telecommunication services;
6. Mobile telecommunication services;
7. Radio and TV broadcasting;
8. “New services”;
9. Rent of technical communication equipment;
10. Revenue from national telephone operators;
11. Other telecommunications services;
12. Other revenues.

Long distance telephone services (domestic and international)

Revenues from subscribers for 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. Services are rendered to Company subscribers through telephone sets and public telephones. 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 services

Revenue from the local telephone services depends on the duration of telephone connections and subscription fee (a permanent component), while time driven billing scheme is applied. If fixed payment scheme is applied, then revenue depends on the subscription fee only. Services are rendered to the Company’s subscribers through telephone sets and public telephones. Revenue from taxaphone services is determined based on duration of telephone connections. The Company recognizes revenues related to the fees for local services in the month the services are rendered.

2. Summary of Significant Accounting Policies (continued)

Revenue (continued)

Fees for connecting to telephone network

The Company recognizes connecting to telephone network fees for indefinite contracts with its subscribers as revenues when the services are complete.

Documentary telecommunication 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.

Mobile telecommunication 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 wire line radio broadcasting network. The revenues comprise monthly fees from subscribers and installation fees for wire line radio sets. The Company recognizes the revenues related to radio broadcasting in the period when the services are rendered.

New services

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

Rent of technical communication equipment

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.

2. Summary of Significant Accounting Policies (continued)

Revenue (continued)

Revenue from national telephone operators

Revenue from national service providers includes two different groups.

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

In 2003, the Ministry of the Russian Federation for antimonopoly policy and entrepreneurial support (MAP) has conducted a reform of the mutual settlements system of multi-regional companies with OAO "Rostelecom" for transit of intercity long-distance traffic. Till August 1, 2003, the revenue calculation has been based on the integral settlement rate, multiplied on the total number of minute-distances (transfer of 1 minute of traffic on 50 kilometer intervals of OAO "Rostelecom" network), transferred through the period.

The integral settlement rate has been calculated as the sum of the linear settlement rate between zones and difference between inbound and outbound termination settlement rates of regional companies. The rate has been calculated and agreed by the MAP once a year according to traffic statistics of the previous year, thus it has not reflected real economical benefits and costs related to changes of the incoming and outgoing structure of the traffic in the current settlement period.

In August 2003, a new and more transparent inter-operators settlement system for intercity traffic was introduced. The new system separates payments of regional operators for the transfer of intercity traffic in OAO Rostelecom's network and termination of the traffic in the zone, where outgoing intercity calls of its own subscriber reaches its destination, and payments for the termination of the incoming intercity traffic from other operators in the network of the Company.

Calculation of the costs for the transit of intercity traffic is based on the new settlement rate, which equals the sum of linear settlement rate multiplied on the quantity of 50 kilometer intervals between zones using termination settlement rate for the zone where the calls are terminated. Revenue calculation for the transit of intercity traffic from OAO "Rostelecom" to the customers of the regional companies is based on the termination settlement rates. New rates have been defined by the order of the MAP dated July 4, 2003.

The second group of revenues from national operators represents services rendered to interconnected telecom operators that transfer outgoing local, intercity and international traffic of their customers via the Company's network, and termination charges for incoming traffic on public network.

2. Summary of Significant Accounting Policies (continued)

Revenue (continued)

Revenues from these operators include revenues from the transit of local, intercity and international traffic. Other revenues of the Company include revenues from following services rendered to national operators: connection to the network (one-off payments), rent of cables, local interconnection, channels and communication equipment as well as data transfer and Internet services.

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

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 interconnection. The Company recognizes revenues related to other services in the period when the services are rendered.

Other revenues

Other revenues not related to provision of communication services 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 Company auxiliary units.

Income Tax

Deferred income tax assets and liabilities are calculated in respect of temporary differences in accordance with IAS 12 “Income Taxes” (IAS 12).

IAS 12 requires the use of a balance sheet liability method for financial reporting and accounting for deferred income taxes. Deferred income taxes are provided for all temporary differences arising between the tax bases of assets and liabilities and their carrying values. The Company’s principal temporary differences arise in respect of property, plant and equipment. 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 utilized.

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.

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

2. Summary of Significant Accounting Policies (continued)

Income Tax (continued)

A deferred tax liability is recognized for all taxable temporary differences associated with investments in subsidiaries, associates, and interests in joint ventures, except to the extent that both of the following conditions are satisfied: the Company is able to control the timing of the reversal of the temporary difference; and it is probable that the temporary difference will not reverse in the foreseeable future.

Value-Added Tax

Value-added taxes related to sales are payable to the tax authorities on an accrual basis based upon invoices issued to subscribers. VAT incurred for purchases may be reclaimed, subject to certain restrictions, against VAT related to sales. VAT that is not currently reclaimable as of the balance sheet date is recognized in the balance sheet on a gross basis.

Contingencies

Contingent liabilities are not recognized in the financial statements. They are disclosed in the accompanying notes unless the possibility of an outflow of resources embodying economic benefit is remote.

Contingent assets are not recognized in the financial statement but disclosed when an inflow of economic benefits is probable.

Subsequent Events

Post-year-end events that provide additional information about the Company’s position at the balance sheet date (adjusting events), are reflected in the financial statements. Post-year-end events that are not adjusting events are disclosed when material.

3. Segment Information

The Company operates as one business segment - telecommunication services in the Southern federal district of Russia. The Company's structure is made of territorial business units providing services to appropriate sectors of the Company's communication network. Management considers that the Company operates in one geographical and operational segment. Management makes investment and strategic decisions based on evaluation of performance of the consolidated Company.

(in thousands, except share and per share amounts)

4. Revenues

	2003	2002
By revenue types		
Long distance telephone services - domestic	**4,822,607**	4,564,130
Local telephone services	**3,740,857**	2,923,668
Fees for connecting to telephone network	**1,221,648**	815,501
Long distance telephone services – international	**1,224,212**	1,042,302
Revenue from national telephone operators	**645,064**	89,897
New services	**580,191**	383,463
Rent of technical communication equipment	**365,816**	128,956
Documentary telecommunication services	**168,576**	196,842
Mobile telecommunication services	**167,148**	107,631
Radio and TV broadcasting	**17,353**	13,981
Other telecommunications services	**596,225**	779,902
Other revenue	**416,365**	848,004
Total	**13,966,062**	11,894,277

During 2003 the Company changed the method of settlements with OAO “Rostelecom” from recording net of charges, which were calculated based on the incoming and outgoing traffic, to recording costs and revenue separately based on the actual traffic. This resulted in an increase in revenue of 241,341 and costs of 273,883. In 2002 revenue and costs related to the settlements with OAO “Rostelecom” are presented in the accompanying financial statements on net basis.

The Company identifies revenue by the following major customer groups:

Customer groups	2003	2002
Residential customers	**7,587,464**	6,574,193
Corporate customers	**4,748,210**	4,209,528
Government customers	**1,056,236**	908,646
Tariff compensation from the state budget	**574,152**	201,910
Total	**13,966,062**	11,894,277

(in thousands, except share and per share amounts)

5. Other Operating Expenses

	2003	2002
General and administrative expenses	**310,307**	283,496
Cost of goods sold	**167,939**	174,321
Contributions to Non-commercial partnership (see Note 30)	**134,665**	71,740
Advertising expenses	**59,321**	22,083
Audit and consulting fees	**30,502**	54,830
Other expenses	**640,141**	590,788
Total	**1,342,875**	1,197,258

Other expenses primarily consist of expenses for property insurance, rent of premises, mechanical and project engineering and for general administration and management.

General and Administrative Expenses

	2003	2002
Fire and other security services	**167,375**	93,135
Transportation services	**41,190**	65,382
Payments to Gossvyaznadzor	**40,135**	30,137
Information services	**26,543**	26,101
Business travel expenses and representation costs	**24,603**	13,781
Other expenses	**10,461**	54,960
Total	**310,307**	322,685

6. Interest Expenses, net

	2003	2002
Interest expense	**482,156**	298,194
Interest expense accrued on financial leases	**167,137**	50,913
Interest income	**(10,451)**	(6,919)
Total	**638,842**	342,188

(in thousands, except share and per share amounts)

7. Other Expenses (Income)

	2003	2002
Charitable contributions	**80,611**	57,777
Fines and penalties	**51,386**	40,808
Assets received free-of-charge	**(15,516)**	(20,626)
Other expenses, net	**111,808**	2,793
Total	**228,289**	**80,752**

8. Income Tax

The income tax charge for the years ended December 31, 2003 and 2002 comprised the following:

	2003	2002 (restated)
Current income tax expense	**630,799**	745,807
Deferred income tax charges (benefit)	**(413,574)**	148,669
Total income tax charge for the year	**217,225**	894,476

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

	2003	2002 (restated)
Profit before income tax and minority interest	**552,378**	1,811,908
Statutory income tax rate	**24%**	24%
Theoretical tax charge at statutory income tax rate	**132,571**	434,858
Increase (decrease) resulting from the effect of:		
Non-taxable income	**(5,480)**	(4,970)
Expenses not deductible for tax purposes	**87,663**	113,572
Inflation effect on deferred tax balance at beginning of year	–	(20,289)
Non-deductible translation and sum differences	**2,471**	866
Permanent elements of monetary gain	–	370,439
Total income tax charge for the year at the effective rate of 38 % (2002 – 49%)	**217,225**	894,476

(in thousands, except share and per share amounts)

8. Income Tax (continued)

The composition of deferred income tax assets and liabilities as of December 31, 2003 and 2002, was as follows:

	December 31, 2003	**December 31, 2002 (restated)**
Tax effects of deferred income tax assets:		
Accounts payable	**51,327**	75,047
Accounts receivable	**75,500**	36,986
Inventory	**4,050**	2,604
Assets received for free	**99,979**	81,607
Deferred income tax asset, total	**230,856**	196,244
Tax effects of deferred income tax liabilities:		
Property, plant and equipment	**(585,721)**	(926,046)
Investment valuation difference	**(30,375)**	(90,634)
Deferred income tax liability, total	**(616,096)**	(1,016,680)
Net deferred income tax liability	**(385,240)**	(820,436)

The movement in net deferred income tax assets and liabilities for the year ended December 31, 2003 was as follows:

Deferred income tax liability as of December 31, 2002, net	(820,436)
Deferred income tax benefit	413,574
Deferred tax expenses due to change of fair value of investments available for sale	21,622
Deferred income tax liability as of December 31, 2003, net	**(385,240)**

9. Earnings per Share

Basic and diluted earnings per share are calculated by dividing the net income for the year attributable to ordinary shareholders (net income for the period less preferred dividends) by the weighted average number of ordinary shares outstanding during the year.

	2003	**2002 (restated)**
Net income (loss) attributable to ordinary shareholders (basic and diluted)	**(9,627)**	675,722
Weighted average number of ordinary shares for basic and diluted earnings per share	**2,960,512,964**	2,960,512,964
Earnings (loss) per ordinary share, Rubles (basic and diluted)	**(0.003)**	0.23

The Company has no financial instruments that can be converted into ordinary shares.

(in thousands, except share and per share amounts)

10. Dividends Declared and Proposed for Distribution

Dividends declared in 2003 for the year 2002

Dividends on ordinary shares, 0.812 Rubles per share	240,394
Dividends on preferred shares, 1.1607 Rubles per share	156,225

Approved at the annual shareholders meeting for the year 2003 (see Note 32 "Subsequent Events")

Dividends on ordinary shares, 0.812 Rubles per share	240,394
Dividends on preferred shares, 0.11114 Rubles per share	108,045

Earnings available for dividends are limited to profits determined in accordance with Russian statutory accounting regulations.

11. Property, Plant and Equipment

	Buildings and constructions	Switches and transmission devices	Construction in progress and equipment for installation	Machines and other	Total
Cost					
At December 31, 2002 (restated)	17,098,820	21,486,849	1,178,166	4,373,148	44,136,983
Additions	–	–	9,814,260	–	9,814,260
Disposals	(158,636)	(437,244)	(40,967)	(80,383)	(717,230)
Commissioning	3,369,171	2,874,331	(7,465,201)	1,221,699	–
At December 31, 2003	**20,309,355**	**23,923,936**	**3,486,258**	**5,514,464**	**53,234,013**
Impairment					
At December 31, 2002 (restated)	(2,837,142)	(1,984,665)	–	(84,952)	(4,906,759)
Charge for the year	–	–	–	–	–
Reversal of impairment loss	16,331	17,916	–	1,385	35,632
At December 31, 2003	**(2,820,811)**	**(1,966,749)**	**–**	**(83,567)**	**(4,871,127)**
Accumulated depreciation					
At December 31, 2002 (restated)	(7,754,113)	(11,272,339)	–	(3,707,515)	(22,733,967)
Charge for the year	(642,310)	(1,486,023)	–	(353,748)	(2,482,081)
Disposals	124,957	399,956	–	75,102	600,015
At December 31, 2003	**(8,271,466)**	**(12,358,406)**	**–**	**(3,986,161)**	**(24,616,033)**
Net book value as of December 31, 2002	**6,507,565**	**8,229,845**	**1,178,166**	**580,681**	**16,496,257**
Net book value as of December 31, 2003	**9,217,078**	**9,598,781**	**3,486,258**	**1,444,736**	**23,746,853**

(in thousands, except share and per share amounts)

11. Property, Plant and Equipment (continued)

The net book value of plant and equipment held under finance leases at December 31, 2003 is 3,460,501 (2002: 512,011). Leased assets are pledged as security for the related finance lease obligations (see Note 25).

In 2003 the Company increased construction in progress by the amount of capitalized interest totaling 92,082 (2002: 22,506). Capitalization rate in 2003 was 9%.

Property, plant and equipment for the total of 6,276,450 as of December 31, 2003 (2002: 3,238,958) is pledged as security under loan and vendor financing agreements (see Note 24).

The Company's accounting records related to property, plant and equipment are not designed to support their presentation in accordance with IAS 16, "Property, Plant and Equipment", IAS 29, "Financial Reporting in Hyperinflationary Economies" and IAS 36, "Impairment of Assets". As such, certain estimates and assumptions were made by management to present fixed assets in the accompanying consolidated financial statements.

The Company plans to hire an independent appraiser to assist in appraisal of the historical value of the property, plant and equipment, in order to make the necessary adjustments to the Company's books and records, to comply with IFRS.

12. Intangible Assets

	Licences	**Software**	**Other**	**Total**
Cost				
At December 31, 2002	2,856	9,728	440	13,024
Additions	2,321	580,352	4,175	586,848
Disposals	–	–	(2,468)	(2,468)
At December 31, 2003	**5,177**	**590,080**	**2,147**	**597,404**
Accumulated Depreciation				
At December 31, 2002	(2,235)	(4,043)	(108)	(6,386)
Charge for the year	(1,124)	(5,376)	(1,250)	(7,750)
Disposals	–	–	456	456
At December 31, 2003	**(3,359)**	**(9,419)**	**(902)**	**(13,680)**
Net book value at December 31, 2002	**621**	**5,685**	**332**	**6,638**
Net book value at December 31, 2003	**1,818**	**580,661**	**1,245**	**583,724**

(in thousands, except share and per share amounts)

12. Intangible Assets, net (continued)

In accordance with the decision of the Board of OAO "Svyazinvest" dated April 14, 2003 the Company was instructed to proceed with the purchase and implementation of an enterprise management system (ERP) based on Oracle E-business Suite software. On May 28, 2003 the Company's Board of Directors approved a supply contract with ZAO "Otkrytye tekhnologii 98" in the amount of 545,296 (approximately 18,089 thousand US dollars at the exchange rate in effect on 28 May 2003).

In accordance with the supply contract, the Company has been provided with non-exclusive licenses for 10,745 users of E-business Suite Professional software as well as other licensed applications.

The Company will commence amortization of these costs upon completion of software implementation. Prior to this time management will periodically assess this asset for impairment. The Company expects to complete this Oracle system implementation in 2006.

13. Investments in Subsidiaries

The consolidated financial statements include the assets, liabilities and financial results of OAO "Southern Telecommunications Company" and its subsidiaries, the major ones being listed as follows:

Name	Main activity	Voting share (%) 2003	Voting share (%) 2002
DZAO "Armavirskiy Zavod Svyazi"	Cable production	**100%**	100%
OAO "Orbita" Recreational House"	Recreational services	**100%**	100%
ZAO "CMTO"	Supply of materials	**100%**	100%
ZAO "Yugsvyazstroy"	Construction services	**100%**	100%
ZAO "Telesot-Alaniya"	Cellular telecommunication services (GSM-900)	**53%**	53%
OAO "Stavtelecom named after V.I.Kuzminov" (OAO "Stavtelecom")	Local, intercity communications, data transfer	**51%**	51%
OOO "Intmashservice"	Communication facilities repairs and support	**100%**	100%
OOO "Faktorial-99"	Informational and commercial agency activity	**100%**	100%
ZAO "Avtotsenter-Yug"	Transport	**100%**	100%

These subsidiaries are Russian legal entities registered in accordance with Russian regulations.

In July-August 2004 the Company increased its stake in OAO "Stavtelecom" to 81% (see also Note 32 "Subsequent Events").

In August 2004 ZAO "Avtotsenter–Yug" was liquidated.

(in thousands, except share and per share amounts)

14. Long-Term Investments in Associates

Investments in associates at December 31, 2003 and 2002 comprised the following:

		As of December 31, 2003		As of December 31, 2002	
Associate	**Activity**	**Voting shares**	**Carrying value**	**Voting shares**	**Carrying value**
ZAO "Volgograd GSM"	Cellular services (GSM)	**50%**	**360,302**	50%	244,644
ZAO "Volgograd-Mobile"	Cellular services (AMPS standard, 800 MHz)	**50%**	**15,821**	50%	47,596
ZAO "Stavropol cellular communications"	Cellular services (AMPS-800 MHz)	**50%**	**15,696**	50%	18,684
OAO "TeleRoss-Kubanelektrosvyaz"	Local and intercity communication services	**50%**	**11,968**	50%	8,294
ZAO "TeleRoss-Volgograd"	Telecommunication services	**50%**	**3,314**	50%	3,472
ZAO "Karachayevo-CherkesskTeleSot"	Cellular communications, GSM-900 MHz	**20%**	**1,633**	20%	57
OAO "SKET"	Creation and development of paid broadcast TV	**45%**	**394**	45%	314
ZAO "Stavtelesot"	Cellular communications	**-**	**-**	41%	187,726
ZAO "Cellular communications - Alaniya"	Cellular services, NMT-450 MHz	**30%**	**250**	30%	240
ZAO "ZanElCom"	Development, assembly, operation and support of regional network IT systems	**45%**	**26**	45%	24
ZAO "Astrakhan-Mobile"	Cellular services (AMPS-800MHz)	**50%**	–	50%	–
ZAO "IR Telekinocompaniya"	Commercial TV and radio broadcasting services	**24%**	–	24%	10
ZAO "Kabardino-Balkar GSM"	Cellular communications, GSM-900 MHz	**20%**	–	20%	629
Total			**409,404**		**511,690**

(in thousands, except share and per share amounts)

14. Long-Term Investments in Associates (continued)

When the Company's share in accumulated losses of these associates exceeded the cost of the respective investments, in accordance with IAS 28 "Accounting for Investments in Associates", the carrying amounts of the investments were reduced to zero.

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 investees. The financial year of all associates ends on December 31 .

Sale of Associates

In March 2002 the Company and OAO "Mobile TeleSystems" entered into agreement for the sale of the Company's 24% stake in ZAO "Kuban GSM" for USD 33.6 million (approximately 1 billion rubles). Gain on disposal amounted to 1,025 mln rubles reflected as an Income from Long-term Investments in the accompanying statement of operations for 2002.

On January 23, 2003 the Company's subsidiary OAO "Stavtelecom" entered into an agreement with OAO "Vympelcom-R", a major cellular operator in the Russian Federation, for the sale of 41% in ZAO "Stavtelesot", a cellular operator in Stavropol Area of the Russian Federation for 17.5 million US dollars (approximately 557 million rubles). The transaction, which resulted in gain from disposal in amount of 369 million rubles, was closed on January 31, 2003.

15. Financial Investments and Other Long-term Assets

As of December 31, 2003 and 2002, the Company's other financial assets and long-term assets comprised the following:

	2003		**2002**	
	Voting shares	**Carrying value**	**Voting shares**	**Carrying value**
Available-for-sale financial assets				
ZAO "Stavtelesot"	**10%**	–		135,827
Other long-term investments				
AKB "Krasnodarbank"	**14%**	**101,364**	14%	101,363
OAO KB "Tsentr-invest"	**14%**	**32,551**	14%	32,551
"Beta concern"	**0.16%**	**26,302**	0.16%	26,302
Other (less than 5,000)		**20,075**		31,497
Less: other long-term investment impairment provision		**(143,898)**		(143,898)
		36,394		47,815
Other long-term assets				
Vendor financing input VAT, non-current		**31,891**		70,622
Loans to personnel		**16,853**		10,428
Accounts receivable		–		2,811
Total		**85,138**		267,503

(in thousands, except share and per share amounts)

15. Financial Investments and Other Long-term Assets (continued)

Impairment provision as of December 31, 2003 and 2002 include a provision for investment in the amount of 101,364 in AKB "Krasnodarbank" and in other companies.

Available-for-sale financial assets as at December 31, 2002 were comprised of a 10% share in ZAO "Stavtelesot". This investment did not have a quoted market price in an active market. Management had estimated the fair value of its interest based on the sale of an indirect 41% interest in ZAO "Stavtelesot" in 2003 (Note 14). In 2003 10% of interest in ZAO "Stavtelesot" were sold for extinguishment of the Company's loan payable to Incombank that amounted to 6,669 thousand Euros (approximately 220,779 rubles) as of December 31, 2002. The debt was purchased by ZAO "Kolidia". In 2003 ZAO "Kolidia" and the Company reached an agreement, under which the Company paid USD 2.7 million (approximately 81,701 rubles) and transferred rights in its 10% interest in Stavtelesot to ZAO "Kolidia" in order to fulfill the obligations.

16. Investments into Joint Activity

Joint Venture with ZAO "Westelcom"

The Company owns 50% of the stock of the joint venture with ZAO "Westelcom" to build and operate digital communications networks in the Republic of Adygeya. The joint venture agreement was executed in November 1995 for the term of 10 years with possible prolongation.

Joint activity investments carried upon proportional consolidation method are included into these financial statements as of December 31, 2003 and 2002 as follows:

	2003	**2002**
Long-term assets	**11,056**	11,593
Current assets	**7,792**	4,447
	18,848	16,040
Current liabilities	**(15,738)**	(14,837)
	3,110	1203
Revenue	**30,552**	31,166
Operational expenses	**(26,838)**	(29,610)
Net profit	**3,683**	1,556

(in thousands, except share and per share amounts)

16. Investments into Joint Activity (continued)

On February 13, 1998 the Company executed a joint venture agreement with OAO “Svyazinvest”. Under this agreement the Company is building a swimming pool on the territory of ZAO “Orbita” Recreational House” (100% subsidiary of the Company). OAO "Svyazinvest" invested 52.5% (approximately 73 million Rubles or 18 million Rubles in terms of purchasing power of the ruble on the date of investment) and the Company invested 47.5% (approximately 66 million Rubles or 16 million Rubles in terms of purchasing power of the ruble on the date of investment).

According to the initial terms of the joint venture agreement the construction was to be completed before June 30, 1999. In the event of failure to meet the contractual terms OAO “Svyazinvest” was obliged to reimburse the investment amount and related fines and penalties at the official rate of the Central Bank of Russia over the entire period from the date of contribution to the joint venture.

After the 1998 economic crisis the construction work was stopped.

In 2002 the Company Board of Directors approved the termination of the joint venture agreement. In March 2003 the Company signed the Novation Agreement on Termination of Joint Venture under which the Company agreed to pay 37,868 to OAO ”Svyazinvest”.

Under the Novation Agreement the Company transferred interest-free promissory notes in the amount of 37,868 to OAO “Svyazinvest” to cover the above debt. The notes were paid up in 2003.

17. Advances to Suppliers of Equipment

Advances to suppliers as of December 31, 2003 and 2002 comprised the following:

	2003	**2002**
Advances for fixed assets acquisition	**492,676**	167,414
Other	**6,400**	5,076
Total	**499,076**	172,490

18. Inventories

Inventories at December 31, 2003 and 2002 included the following:

	2003	**2002**
Cable, materials and spare parts for telecommunications equipment	**591,073**	397,802
Finished goods and goods for resale	**44,406**	37,645
Other inventories	**379,651**	245,121
Less: provision for impairment	**(16,877)**	(22,235)
Total	**998,253**	658,333

(in thousands, except share and per share amounts)

19. Accounts Receivable

Accounts receivable as of December 31, 2003 and 2002 comprised the following:

	2003	2002
Accounts receivables – settlements with subscribers	**1,200,708**	1,091,229
Other accounts receivables	**9,086**	8,168
Less: Provision for doubtful accounts	**(419,158)**	(198,411)
Total	**790,636**	900,986

The Company identified account receivables by the following major customer groups:

	2003	2002
Residential customers	**470,160**	443,613
Government customers, including tariff compensation from the state budget	**410,680**	212,919
Corporate customers	**319,868**	434,697
Total	**1,200,708**	1,091,229

The Company invoices its governmental and corporate customers on a monthly basis. For residential customers, 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 rubles, in effect at the time the calls are made. In certain cases the Company managed to collect penalties for payment delays and to enforce reimbursement in arbitration court.

20. Other Current Assets

As of December 31, 2003 and 2002 other current assets comprised the following:

	2003	2002
Value added tax	**1,261,754**	358,251
Notes receivable	**230,948**	67,251
Income tax prepaid	**158,454**	81,223
Prepayments	**155,182**	87,384
Other taxes prepaid	**31,144**	16,668
Other	**12,540**	4,833
Less: allowance for other current assets	**(24)**	(47,596)
Total	**1,849,998**	568,014

Impairment provision related to prepayments.

(in thousands, except share and per share amounts)

21. Cash and Cash Equivalents

As of December 31, 2003 and 2002 cash and cash equivalents comprised the following:

	2003	2002
Cash at bank and on hand	**403,412**	213,577
Deposits with maturity of less than 3 months	–	14,694
Cash equivalents	**701**	1,649
Total	**404,113**	229,920

Short-term deposits include deposits with maturity from one to three months depending upon the current cash demands.

22. Share Capital

	2003		2002	
	Shares	Share capital	Shares	Share capital
Preferred shares at par value RUR 0.33		**320,810**		320,810
shares outstanding as of December 31	**972,151,838**		972,151,838	
declared shares	**32,711,532**		32,711,532	
Ordinary shares at par value RUR 0.33		**976,969**		976,969
shares outstanding as of December 31	**2,960,512,964**		2,960,512,964	
declared shares	**130,814,343**		130,814,343	
Total share capital		**1,297,779**		1,297,779

As a result of the reorganization (see Note 1) the state registration of amendments to the charter documents was completed on January 23, 2003.

The share capital account represents the authorized capital of the Company as stated in the charter documents. The Company had 2,960,512,964 ordinary shares and 972,151,838 preference shares type A issued as of December 31, 2003.

All shares have a par value of 0.33 rubles. Of the share capital issued as of December 31, 2003, 75.28% was attributable to ordinary shares and 24.72% attributable to preference shares, A-type. The ordinary shareholders are allowed one vote per share. Preference shares A-type are non-voting. All ordinary shares and preference shares A-type are eligible for distribution of ruble earnings in the form of dividends available in accordance with Russian statutory accounting regulations. Each preference share A-type is entitled to a minimum of an annual dividend in the amount 10% of statutory net income. Dividends on preference shares A-type may not be less than dividends on ordinary shares. Shareholders of preference shares A-type have a preference right to recover the par value of preference shares in liquidation. Preference shares obtain the right to vote on all matters within the remit of the General Shareholders' Meeting if at the previous Annual Shareholders' Meeting it was decided not to pay a dividend on preference shares even though the Company had statutory net profit for the year, the right is terminated at the moment of the first full payment of preferred dividends.

22. Share Capital (continued)

In 1998 the Company executed a depositary agreement with the Bank of New York regarding placement of American Depositary Receipts (ADRs), Level 1. The issue was registered on February 5, 1998. On April 23, 2003 the above ADR program was transferred from the Bank of New York to JP Morgan Chase Bank. The depositary agreement between the Company and JP Morgan Chase Bank was signed on April 22, 2002 and revised on December 15, 2002 in accordance with the reorganization (see Note 1 “General Information”). In accordance with the depositary agreement, each ADR represents 50 ordinary shares of the Company. As of December 31, 2003, 2,228,802 ADRs represented 111,440,100 deposited ordinary shares, which constituted 3.76% of total ordinary shares issued.

The Company’s shareholding structure (in thousands of shares) as of December 31, 2003 was as follows:

	Ordinary shares		**Preference shares**		
	Number	**%**	**Number**	**%**	**Total**
OAO “Svyazinvest”	1,500,671	50.69	–	–	1,500,671
Other legal entities	1,084,006	36.61	713,767	73.42	1,797,773
Individuals	375,836	12.70	258,384	26.58	634,220
Total	**2,960,513**	**100**	**972,151**	**100**	**3,932,664**

23. Minority Interest in Subsidiaries

As of December 31, 2002	**148,539**
Minority interest in net income of subsidiaries	188,555
Dividends to minority shareholders	(155,185)
As of December 31, 2003	**181,909**

(in thousands, except share and per share amounts)

24. Loans and Borrowings

	Interest rate range	Maturity date	2003	2002
Short-term loans and borrowings				
Bank loans:				
Bank loans (Russian rubles)	14% –16%	2004	**2,321,402**	775,185
Total bank loans			**2,321,402**	775,185
Bonds (Russian rubles)	14.24%	2006	**1,560,861**	–
Vendor financing	–	–	**441,240**	328,420
Promissory notes (rubles)	12.5–15%	2004	**187,100**	71,499
Other short-term loans and borrowings	–	2004	–	52,261
Total short-term loans and borrowings			**4,510,603**	1,227,365
Long-term loans and borrowings				
Bank loans				
Bank loans (Russian rubles)	12 –19%	2004 –2008	**4,920,746**	418,196
Bank loans (USD)	14.5%	2004	**54,847**	130,208
Total bank loans			**4,975,593**	548,404
Vendor financing:				
Vendor financing (USD)	7-8%	2004 –2005	**226,186**	553,131
Vendor financing (YEN)	7.56%	2006	**51,653**	38,257
Vendor financing (Euro)	6–8.5%	2004 –2008	**1,056,559**	1,143,085
Total vendor financing			**1,334,398**	1,734,473
				–
Promissory notes (Russian rubles)	–	–	–	39,784
Other long-term loans and borrowings	0 –21%	2004 –2007	**65,750**	83,085
Less: Current portion of long-term loans and borrowings			**(1,406,833)**	(1,406,137)
Total long term borrowings			**4,968,908**	999,609

As of December 31, 2003 and 2002 short-term loans and borrowings included 501,768 and 341,128 of interest payable, accordingly.

(in thousands, except share and per share amounts)

24. Loans and Borrowings (continued)

As of December 31, 2003, long-term borrowings had the following maturity schedule:

Maturity date	Bank loans	Bonds	Vendor financing	Promissory notes	Other	Total
2004	2,734,187	1,560,861	1,428,053	187,100	7,235	**5,917,436**
2005	1,728,722	–	69,165	–	34,670	**1,832,557**
2006	1,659,786	–	31,021	–	–	**1,690,807**
2007	600,000	–	156,236	–	–	**756,236**
2008 and thereafter	574,300	–	91,163	–	23,845	**689,308**
Total	7,296,995	1,560,861	1,775,638	187,100	65,750	**10,886,344**

Short-term Loans

Bonds

On September 18, 2003 the Company issued 1,500,000 interest-bearing coupon non-convertible bonds, series 01, at a par value of RUR 1,000 each. The bonds have six coupons. Payments on the first coupon are made on the 182nd day from the date of issue, and payments on the remaining coupons are made on each of subsequent 182 days. The interest rate on the coupons was determined at 14.24% per annum. The bonds mature in 1,092 days from the placement date, i.e. on September 14, 2006. Coupon interest accrued as of December 31, 2003 amounted to 60,861. The bonds have an option of early redemption in September 2004 (Note 32 "*Subsequent Events*"). Therefore, they are recorded as the short-term borrowings as of December 31, 2003.

Bank Loans

Short-term ruble borrowings mainly represent bank loans received for working capital financing purposes. Most of these loans are collateralized with telecommunications equipment.

The most significant short-term loan agreements concluded in 2003 by the Company are summarized as follows:

Rosbank

In November of 2003 the Company entered into a loan agreement with Rosbank for 1,000,000 at 15% per annum. As of December 31, 2003 the outstanding liability under this agreement was 1,000,000. The loan was not secured. The loan was repaid in May 2004.

Alfa-Bank

In April-December of 2003 the Company entered into four loan agreements with Alfa-bank for the amount of 995,000 at 14-19% per annum. As of December 31, 2003 outstanding liabilities under these agreements amounted to 913,000. The Company re-paid the loans for the amount of 300,000 in April 2004 and for the amount 438,000 in June, 2004. Loans for the amount of 175,000 are due in December 2004. Loans were not secured.

24. Loans and Borrowings (continued)

Short-term Loans (continued)

Promstroybank

In August of 2003 the Company entered into a loan agreement with Promstroybank for 250,000 at 14.5% per annum. As of December 31, 2003 the outstanding liabilities under this agreement amounted to 250,000. The loan is secured by equipment in the total amount of 334,298. The loan was repaid in February, 2004.

Sberbank, overdraft

In December of 2003 the Company entered into overdraft agreement with Sberbank at 16% per annum. Amount outstanding as of December 31, 2003 was 71,218.

Promissory Notes

On November 20, 2003 the Company executed promissory notes sales and purchase agreements with ZAO “RTC-Invest”. Promissory notes are to be redeemed in 2004. As of December 31, 2003 the Company had an outstanding amount of 64,746. Interest is charged at the rate of 14-15% per annum.

On November 28, 2003 the Company executed a promissory notes sales and purchase agreement with OAO “Promstroybank”. The notes are to be redeemed in 2004. As of December 31, 2003 the Company had an outstanding liability in the amount of 122,354. Interest is charged at the rate of 12.5% per annum.

Long-term Loans

Bank Loans

Below are the main long-term bank agreements concluded by the Company:

Sberbank RF

In 2003 the Company entered in a number of loan agreements with Sberbank RF for total amount of 2,900,000. The loans bear interest at 13-16% per annum. As of December 31, 2003 the outstanding liabilities under these agreements amounted to 2,900,000. Loans are to be repaid in 2005-2008. The loan is secured by equipment in the total amount of 1,891,033.

Rosbank

In October 2003 the Company entered into a loan agreement with Rosbank. As of December 31, 2003 the outstanding liabilities under these agreements amounted to 1,000,000. Interest is accrued at 15%. The loan is due in June, 2006. The loan is secured by equipment in the total amount of 1,807,263.

24. Loans and Borrowings (continued)

Long-term Loans (continued)

Alfa-Bank

On December 19, 2001, the Company entered into a loan agreement with Alfa Bank for the amount of USD 6,517 thousand (approximately 205 million rubles). The loan is repayable in equal installments up to October 20, 2004. Interest is accrued at 7% per annum. The liability under this agreement included in the accompanying consolidated balance sheet as at December 31, 2003 amounted to 54,847 (130,208 – 2002). The loan is not secured.

In 2003 the Company entered into loan agreement with Alfa-bank for a total of 574,579. As of December 31, 2003 the outstanding liabilities under the agreement amounted to 574,579. Interest is accrued at 15%. The loan is due on December 2006. The loan is secured by equipment in the total amount of 1,286,004.

International Moscow Bank

In August 2003 the Company entered into two loan agreements with International Moscow Bank. As of December 31, 2003 the outstanding liabilities under these agreements amounted to 300,000. Interest is accrued at 12.35%. The loan is due on June, 2005. The loan is secured by equipment in the total amount of 429,045.

Supplier loans

Vnesheconombank

In 1995-1996 the Russian Ministry of Finance (hereafter “the Ministry”) granted the Company long-term financing for the purchases of telecommunication equipment from various foreign suppliers. Vnesheconombank has been acting as an agent of the Ministry on collection of payments from the Company. Liability is denominated in Euro. As of December 31, 2003 the principal amount of debt due to Vnesheconombank were 805,230 (in 2002 – 741,359), including the long-term portion of 156,236 and the short-term portion of 648,994. The interest rate was 8.5%. As of December 31, 2003 accrued interests in amount of 262,769 were included in short-term borrowings

Siemens

On December 14, 1995, the Company entered into an agreement with Siemens AG (Germany), under which Siemens AG delivered and installed telecommunication equipment to the Company. The amounts payable under this agreement are denominated in Euro and are repayable in equal installments during 2004-2008. Interest is accrued at 6% per annum. The amount outstanding as of December 31, 2003 is 172,372 (in 2002 – 150,788). The loan is not secured.

Center of Economic Development

In 2001 and 2002 the Company entered into various agreements with Center of Economic Development (hereinafter “the Center”), under which the Center delivered telecommunication equipment to the Company. Related liability is denominated in USD. Part of these loans bears interest at 8% per annum. The amount of non-interest bearing loans as at December 31, 2003 represents the present value of future payments under the agreements. Interest is accrued at a weighted average interest rate on the similar interest bearing borrowings of the Company denominated in USD, which in 2003 approximated 7.6% per annum. As of December 31, 2003 the liability amounted to 84,149 (in 2002 – 124,952). The loans are not secured.

(in thousands, except share and per share amounts)

24. Loans and Borrowings (continued)

Long-term Loans (continued)

Other supplier loans

In 2000-2002 the Company signed several contracts with OOO "Mashpriborcom", OOO "Iskratel" and ZAO "NEC Neva Communication Systems" under which suppliers were to deliver and install telecommunication equipment. The liabilities under these contracts were denominated in Euros, US dollars and Yens. The total amount of liabilities as of December 31, 2003 amounted to 272,647. Some of these contracts fix the interest rate at 6-8% per annum. Arrears on interest-free loans as of December 31, 2003 represent the current value of deferred payments under the contracts. Interest on these contracts is charged on the basis of average weighted annual interest rate. The rate is calculated on the basis of all interest-bearing loans of the Company received in the corresponding periods and denominated in Euros and in US dollars. The estimated rate is approximately 7.6 % per annum.

Other long-term loans and borrowings

Stavtelesot

In 1997 the Company concluded an agreement with ZAO 'Stavtelesot', under which Stavtelesot provided the Company a non-interest bearing loan. In accordance with the initial agreement, the loan matures in 2011. As of December 31, 2003 the principal amount equaled to 23,845. Interest on the contract is charged on the basis of average weighted annual interest rate. The loan is not secured.

Customer loans

In 1997-2003 the Company attracted funds from the population for development of telecommunications. The Company covers the obligations under these contracts by installation of telephones and cash payments. As of December 31, 2003 the Company's total obligations to the population were 3,605.

25. Finance Lease Obligations

The Company has finance lease contracts for telecommunication equipment. Future minimum lease payments under finance lease contracts together with the discounted value of the minimum lease payments as of December 31, 2003 and 2002 are as follows:

	2003	**2002**
Financial lease payments		
Within one year	**1,089,268**	181,865
After one year but not more than five years	**2,492,100**	322,233
Total minimum lease payments	**3,581,368**	504,098
Less amounts representing finance charges	**(1,251,107)**	(165,538)
Discounted value of minimum lease payments	**2,330,261**	338,560
Financial lease liabilities		
Long-term liabilities	**1,710,467**	225,659
Short-term liabilities	**619,794**	112,901
Total financial lease liabilities	**2,330,261**	338,560

In 2003 and 2002, the Company's primary lessors were OAO "RTC-Leasing" and OOO "Promsvyazleasing". In 2003, the effective interest rate on leasing liabilities ranged from 24% to 31% per annum (2002 - from 25% to 36%, accordingly).

(in thousands, except share and per share amounts)

26. Accounts Payable and Accrued Liabilities

As of December 31, 2003 and 2002, the Company's accounts payable and current liabilities comprised the following:

	2003	2002
Trade accounts payable and accounts payable for capital construction	**1,060,364**	460,148
Salaries and wages, and benefits payable	**366,203**	188,307
Advances received from subscribers	**329,297**	221,933
Other accounts payable	**694,696**	434,801
Total	**2,450,560**	1,305,189

Other accounts payable include outstanding settlements with suppliers and contractors in relation to other services, acquired inventory commitments, utilities and electricity.

27. Taxes and Payroll Related Obligations

As of December 31, 2003 and 2002, the Company had the following taxes payable:

	2003	2002
Value-added tax	**164,746**	235,620
Unified social tax	**98,979**	71,548
Land tax	**39,928**	40,109
Tax penalties and fines	**39,963**	17,246
Sales tax	**30,747**	43,785
Income tax	**9,812**	47,819
Other	**37,430**	60,773
Total	**421,605**	516,900

28. Pension Plans and Employee Benefits

In 2003 the Company made various payments to employees in addition to salaries. These payments generally represent financial aid to the Company's employees with limited abilities and bonuses to employees who had made no breaches of internal policies during the last fiscal year. Such benefits were included into "Wages, salaries, other benefits and payroll taxes" of the consolidated Statement of Operations for the year ended December 31, 2003 in the amount of approximately 68,433 (2002: 65,931).

In addition to statutory pension benefits, the Company also contributes to defined benefit plans, which covers most of its employees. Non-government pension fund "Telecom-Soyuz", which is related to the Company (see Note 30 "Transactions with related parties"), maintains the plan. The plans provide for payment of retirement benefits starting from statutory retirement age, which is currently 55 for women and 60 for men. The benefits are based on a formula recognizing minimal statutory pension, length of service both in the Company and in the telecommunications industry, as well as final average earnings and position in the Company at retirement. The benefits are not vesting and are subject to the employee retiring from the Company on or after the above-mentioned ages. The Company makes contributions to the pensions funds as a set percentage of the employees' salaries or in the amount set forth in the agreement with the pension fund subject to a specific pension arrangement.

28. Pension Plans and Employee Benefits (continued)

The Company has not made an actuarial determination of its obligations according to provisions of the accounting policy (see Note 2 “Summary of Significant Accounting Policies”) and hence has not recorded its obligations or made disclosures required under IAS 19, “Employee Benefits”, pertaining to the value of obligations and assets of the plan as of December 31, 2003 and 2002.

29. Commitments and Contingencies

General Contingencies

The Russian economy while deemed to be of market status beginning in 2002, continues to display certain traits consistent with that of a market in transition. These characteristics have in the past included higher than normal historic inflation, lack of liquidity in the capital markets, and the existence of currency controls, which cause the national currency to be illiquid outside of Russia. The continued success and stability of the Russian economy will be significantly impacted by the government’s continued actions with regard to supervisory, legal and economic reforms.

Management cannot predict what effect changes in fiscal, political or tariff policies may have on the Company’s current financial position or its ability to make future investments in property, plant and equipment. The consolidated financial statements do not include any adjustments that might result from these uncertainties. Related effects will be reported in the financial statements as they become known and estimable.

Tax Laws and Regulations

Legislation and regulations regarding taxation and foreign currency transactions in Russia continue to evolve as the government manages the transformation from a command to a market-oriented economy.

During 2002, the Russian Federation enacted a new tax code with significant modifications from the prior law. The various legislative and regulatory documents are not always clearly written and their interpretation is subject to opinions of local tax authorities, of the Central Bank and Ministry of Finance officials. Instances of inconsistent opinions of these authorities are not unusual. The current regime of penalties and interest related to reported and discovered violations of Russia’s laws, decrees and related regulations is severe. Interest (at the Central Bank of RF official rates) and fines are levied when an understatement of tax liability is discovered. As a result, penalties and interest can result in amounts that are multiples of any unreported taxes.

The Company believes that it has paid or accrued all taxes that are applicable. Where practice concerning the provision of taxes was unclear, the Company has accrued tax liabilities based on management’s best estimate. The Company’s policy is to accrue for contingencies in the accounting period in which a loss is deemed probable and the amount is reasonably determinable. As of December 31, 2003 the Company accrued tax contingencies in amount of 35,800. Because of the uncertainties associated with the Russian tax and legal systems, the ultimate amount of taxes, penalties and interest assessed, if any, may be in excess of the amount expensed to date and accrued as of December 31, 2003.

29. Commitments and Contingencies (continued)

Insurance Coverage

The Russian insurance industry is in a developing state and many forms of insurance protection common in other parts of the world are not yet generally available. During 2003, 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.

Litigation, Claims and Assessments

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 of the Russian legal system or the resulting effect of any such developments on the Company's financial condition or future results of operations. In the foreseeable future economic instability in the country may affect the Company's operations. The financial statements do not include any adjustment that may result from these uncertainties.

Oracle software implementation

According to agreements executed by the Company in 2004, it has undertaken to invest 720,326 into subsequent installation of Oracle E-business software. The Company intends to finalize implementation of the system in 2006.

Financial Lease

In 2003 the Company executed several financial leasing agreements with ZAO "RTC-Leasing", a subsidiary of OAO "Rostelecom", according to which the contracted equipment will be delivered in 2004. The contractual cost of the equipment under the lease agreements, including the assembly costs and other capitalized services, amounted to approximately 134,740.

Capital Investments

At December 31, 2003 and 2002 the Company has commitments of 987,388 and 463,791, accordingly, for capital investments into modernization and expansion of its network.

Guarantees Issued

As of December 31, 2003 the Company has guaranteed credit line facilities provided by Sberbank and Rosbank to ZAO "RTC-Leasing", a lessor of telecommunication equipment (see Note 30 "*Transactions with Related Parties*" below). The guarantees amounted to 1,187,827 and 207,150, accordingly.

As of December 31, 2003 the Company has guaranteed two Alfa Bank loans to ZAO "Volgograd Mobile", the Company's associate, in total amount of 49,000.

The Company's management does not expect occurrence of any material obligations related to these guarantees.

(in thousands, except share and per share amounts)

30. Transactions with Related Parties

OAO "Svyazinvest"

The Company's parent entity - OAO "Svyazinvest" - was wholly owned by the Russian Government until July 1997 when the Government sold 25% plus one share of the Charter Capital of OAO "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 OAO "Svyazinvest" and its subsidiary companies.

The Government's influence is not confined to its share holdings in OAO "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.

As of 31 December 2002 the Company had promissory notes payable to OAO "Svyazinvest" (see Note 16). Promissory notes were redeemed in 2003.

OAO "Rostelecom"

OAO "Rostelecom", a majority owned subsidiary of OAO "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 OAO "Rostelecom" and terminated outside of the Company's network is stated as interconnection charges. Further, OAO "Rostelecom" uses the Company's network to provide incoming long-distance and international traffic to its subscribers and partner operators. Transactions undertaken by the Company with OAO "Rostelecom" reported in the accompanying consolidated financial statements as at December 31, 2003 and 2002 and for the years then ended were as follows:

	2003	**2002**
Expenses on traffic transfer and rent of channels from Rostelecom	**1,612,110**	1,338,227
Revenue received from Rostelecom	**262,511**	21,170
Accounts payable to Rostelecom as at the year-end	**245,090**	227,650

30. Transactions with related parties (continued)

OAO “RTC-Leasing”

In October 2003 OAO “Rostelecom”, which owned 27% of ordinary shares of OAO “RTC-Leasing” and exercised financial and operational control over the RTC-Leasing’s activities, sold all shares of OAO “RTC-Leasing” to a third party. As a result of this transaction, starting from December 1, 2003 OAO “RTC-Leasing” is not considered to be the Company’s related party and is not included into the Group of companies owned by OAO ”Svyazinvest”.

OAO “RTC-Leasing” purchases telecommunication equipment from domestic and foreign suppliers and leases the equipment. The Company’s obligations to OAO “RTC-Leasing” under these finance leases as of December 31, 2003 comprised 2,159,320 (2002: 131,606), i.e. 93% (2002: 39%) of the Company’s total obligations for finance leases (see Note 25 “*Finance Lease Obligations*”). In 2003 The Company concluded agreements with OAO “RTC-Leasing” totaling (excluding VAT) - 2,707,847 (2002 – 901,745). In 2003 interest expense on agreement with OAO “RTC-Leasing” amounted to 108,042 (2002 – 35,639).

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 lease communication lines and they are generally charged lower tariffs as approved by the Ministry of Antimonopoly Policies and Entrepreneurship Support 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 crime control.

Government subscribers accounted for approximately 11.1% of gross trade accounts receivable as of December 31, 2003 (2002: 15.7%). Amounts outstanding from government subscribers as of December 31, 2003 amounted to 133,279 (2002: 184,418).

(in thousands, except share and per share amounts)

30. Transactions with Related Parties (continued)

Associates

The Company's consolidated financial statements comprise the following amounts and transactions with associates as of and for the year ended December 31, 2003 and 2002:

	2003	2002
Accounts receivable from associates:		
OOO "Yug-Giprosvyaz"	**7,437**	–
ZAO "Volgograd-GSM"	**1,022**	12,666
Total:	**8,459**	12,666
Accounts payable to associates:		
OOO "Yug-Giprosvyaz"	**35,189**	–
ZAO "Volgograd-Mobile"	**7,539**	25
ZAO "Volgograd-GSM"	**3,289**	548
Total:	**46,017**	573
Sales to related parties:		
ZAO "Volgograd-GSM"	**62,692**	12,662
OOO "Yug-Giprosvyaz"	**8,062**	–
ZAO "Volgograd-Mobile"	**3,113**	5,917
Total:	**73,867**	18,579
Acquisitions from related parties:		
OOO "Yug-Giprosvyaz"	**104,799**	–
ZAO "Volgograd-GSM"	**3,884**	1,522
AO "Volgograd-Mobile"	**478**	307
Total:	**109,161**	1,829

The Company also provided services to other associates including connection to public network, rental of premises to install equipment and establish offices. The total effect of such transactions on the Company's financial position is insignificant.

(in thousands, except share and per share amounts)

30. Transactions with Related Parties (continued)

Non-Commercial Partnership Center for Research of Problems in Development of Telecommunications

Non-commercial partnership Center for Research of the Problems in Development of Telecommunications (hereinafter "the Partnership") is an entity related to OAO "Svyazinvest". The Company has an agreement with the Partnership, under which it provides financing for mutually beneficial projects undertaken by the Partnership on behalf of the Company and other subsidiaries and associates of OAO "Svyazinvest". Payments to the Partnership included in other operating expenses in the accompanying consolidated statement of operations for the year ended December 31, 2003 amounted to 134,665 (2002: 71,740).

NPF "Telecom-Soyuz"

The Company has a number of pension agreements with NPF "Telecom-Soyuz" which is a party related to OAO Svyazinvest (see Note 28 "Pension Plans and Employee Benefits"). Payments to this pension fund in 2003 amounted to 67,823 (2002: 56,483).

Compensation to the Company's management

In 2003, compensation to the members of the Company's Board of Directors totaled 12,799 (2002: 4,384).

31. Financial Instruments

Fair value

The management believes that the value at which the financial instruments are carried in the accompanying consolidated balance sheet as of December 31, 2003 and 2002, approximates their fair value.

Interest rate risk

The following table presents as of December 31, 2003 and 2002 the carrying amount by maturity of the Company's financial instruments that are exposed to interest rate risk:

Year ended December 31, 2002:

	< 1 year	1-5 years	> 5 years	Total
Fixed rate				
Short-term obligations	1,227,365	–	–	1,227,365
Long-term obligations	608,504	695,265	32,483	1,336,252
Finance lease obligations	112,901	225,659	–	338,560
Floating rate				
Long-term obligations	797,633	271,861	–	1,069,494
Total:	**2,746,403**	**1,192,785**	**32,483**	**3,971,671**

(in thousands, except share and per share amounts)

31. Financial Instruments (continued)

Year ended December 31, 2003:

	< 1 year	1-5 years	> 5 years	Total
Fixed rate				
Short-term obligations	4,510,603	–	–	4,510,603
Long-term obligations	325,907	4,788,827	23,845	5,138,579
Finance lease obligations	619,794	1,710,467	–	2,330,261
Floating rate				
Long-term obligations	1,080,926	156,236	–	1,237,162
Total:	**6,537,230**	**6,655,530**	**23,845**	**13,216,605**

Interest on financial instruments classified as floating rate is revised at intervals less than one year.

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.

32. Subsequent Events

Issue of bonds

On September 2, 2004 the Company made an irrevocable offer for early redemption of the Series 01 bonds at 100% par value. September 10, 2004 was the end of the period of presentation of the Company's Series 01 bonds for payment under the irrevocable offer. None of bondholders exercised the right of earlier redemption.

On February 11, 2004 the Company issued 1,500 thousand non-convertible interest-bearing bonds, Series 02, par value of 1,000 Rubles each. The bonds mature in three years, with semiannual coupons. The interest rate of the first and second coupons is 9.25% annually. They will be repaid in 1,092 days from the date of placement. The bond issue has two options of earlier redemption at par value - in February 2005 and February 2006.

On October 6, 2004 the Company issued the non-convertible interest-bearing documentary bonds Series 03. The total value of the issue is 3.5 billion Rubles, par value 1,000 Rubles each. The bonds mature on the 1,830th day (in five years) from the date of placement. The bond issue has two options of earlier redemption at par value - in April 2006 and October 2007.

32. Subsequent Events (continued)

Sales of associates

On May 28, 2004 the Company sold a 50% interest in ZAO ”Astrakhan Mobile” and 50% interest in ZAO “Volgograd Mobile” to the cellular operator OAO “Mobile TeleSystems”. According to agreements with MTS, a 50% interest in ZAO ”Astrakhan Mobile” was sold for 1.1 million US dollars and a 50% interest in ZAO “Volgograd Mobile” for 2.9 million US dollars.

In September 2004 the Company sold 30% of shares of the NMT-450 operator ZAO “Sotovaya Svyaz-Alaniya” to OOO “MS-Direct” for 300 thousand US dollars.

Step acquisition of subsidiary

In 2004 the Company increased its share in OAO “Stavtelecom named after V.I.Kuzminova”, the fixed line operator in Stavropol region, up to 81%. The interest in OAO “Stavtelecom” from 51% to 81% was increased in two stages: the first 20% was purchased on July 30, 2004 and the remaining 10% on August 10, 2004. The acquisition was made for 925 thousand US dollars in total.

Loan and borrowings contracts concluded in 2004

Alfa-bank

In 2004 the Company entered in a number of loan agreements with Alfa-Bank for the total amount of 1,307,600 at 12%-13.5% per annum. Loans are to be repaid in 2005-2006. The loan is secured by equipment in the total amount of 1,558,785.

Promstroybank

In February and April 2004 the Company entered in a number of loan agreements with Promstroybank for the total amount of 1,375,000 at 13%-13.5% per annum. Loans for the amount of 375,000 are to be repaid in 2004 and for the amount of 1,000,000 in 2007. The loan is secured by equipment in the total amount of 2,334,677.

Rosbank

In 2004 the Company entered in a number of loan agreements with Rosbank for the total amount of 2,000,000 at 13% per annum. Loans are to be repaid in 2007. Loans are secured by equipment in the total amount of 1,859,904.

Yugbank

In 2004 the Company entered in a number of loan agreements with Yugbank for the total amount of 490,000 at 10%-13% per annum. Loans are to be repaid in 2004. Loans are secured by equipment in the total amount of 775,842.

32. Subsequent Events (continued)

Loan and borrowings contracts concluded in 2004 (continued)

Sberbank RF

In 2004 the Company entered in a number of loan agreements with Sberbank RF for the total amount of 464,000 at 11.6%-12.5% per annum. Loans are to be repaid in 2005. The loan is secured by equipment in the total amount of 346,235.

Volgo-Kaspiyskiy Bank

In 2004 the Company entered in a number of loan agreements with Volgo-Kaspiyskiy Bank for the total amount of 130,000 at 12% per annum. Loans are to be repaid in September 2005. Loans are secured by equipment in the total amount of 142,617.

Vneshtorgbank

In July 2004 the Company and Vneshtorgbank (VTB) entered an agreement on strategic cooperation, under which the bank will provided crediting, financing of investment projects and programs, service of foreign trade activities of the Company, rendering of services on a securities market, and also consulting and information services, and bank service of the company. As of October 8, 2004 VTB provided two loans in total amount of 560 million rubles (280 million rubles each).

RTC-Invest

In 2004 the Company executed promissory notes sales and purchase agreements with ZAO “RTC-Invest” in amount of 1,000 million rubles. Promissory notes are to be redeemed in 2005. Interest is charged at the rate of 13.7-15.7% per annum.

Finance lease agreements with OAO “RTC-Leasing”

In 2004 the Company signed several finance lease contracts with OAO “RTC-Leasing” (see Note 30 “*Transactions with related parties*”). The cost of equipment supplied under these contracts including the cost of installation and other services to be capitalized will be approximately 2,910 million Rubles, and the related non-discounted future lease payments will be approximately 3,420 million Rubles.

Dividends

On June 30, 2004, the general meeting of the Company’s shareholders approved dividends for 2003 in the amount of 0.11114 Rubles per preferred share and 0.0812 Rubles per ordinary share. Total dividends declared amounted to 108,045 and 240,394 for preferred and ordinary shares, respectively. Dividends will be accrued when declared in 2004.

32. Subsequent Events (continued)

New tariffs for telecommunication services

According to the decision of the Board of the RF Federal Tariff Service (FST) as of August 31, 2004 from October 1, 2004 national long-distance tariffs for all categories of customers in certain tariff zones were reduced by 5 %.

Following the above decision FST also approved the weighted average increase in the local telephone connection tariffs will be 30.0% for individuals and 26.4% for organizations.

Telecommunication reforms

On January 1, 2004, a new law on telecommunications came into effect in Russia. The law sets the legal basis for the telecommunications business in Russia and defines the status that state bodies have in the telecommunications sector. The new law may increase the degree of regulators’ oversight over the Company’s operations and until such time as appropriate regulations consistent with the new law are promulgated, there will be a period of confusion and ambiguity as regulators interpret the legislation.

Under the new law, the Company is obliged to provide services under similar circumstances and equal conditions for connecting telecommunications networks and for carrying traffic from communications operators rendering similar services and to render connection services and the services involved in carrying traffic to these operators under the same terms and of the same standard, like for its own structural subdivisions and for affiliated parties.

According to the new telecommunication law, the individual subscriber has an option for local service to be paid based on subscription or by-the-minute payment system.

Management cannot predict to what degree (if at all) the new law will affect the Company’s operations.

Constitutional Court Resolution

In 2004, Resolution No. 169-O of the Constitutional Court of the Russian Federation dated April 8, 2004 has become publicly available. The resolution has the possible effect of deferring the timing in which companies are able to offset input VAT to the extent the creation of such VAT is deemed to be attributable to the utilization of borrowed funds. In the event local taxing authorities would assert and successfully defend such an interpretation, the result could have a material adverse impact on the Company's financial condition. As of the date of this report, management is unable to predict the outcome of this uncertainty.