Open Joint Stock Company
“Southern Telecommunications Company”

Consolidated Financial Statements

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

OJSC “Southern Telecommunications Company”

Consolidated Financial Statements

For the year ended December 31, 2005

Contents

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Independent Auditors' Report

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

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

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

3. As described in Note 2 "Basis of Presentation of the Financial Statements" and Note 5 "Property, Plant and Equipment", the Company transitioned to International Financial Reporting Standards (IFRS) at January 1, 2003 and applied an exemption in IFRS 1, "First-time Adoption of International Financial Reporting Standards", which permits to measure property, plant and equipment at the date of transition to IFRS at fair value and use that fair value as deemed cost. However, we were not able to satisfy ourselves as to whether the carrying amounts of property, plant and equipment as at January 1, 2003 were representative of fair value. Accordingly, we were unable to determine whether the carrying value of property, plant and equipment as of December 31, 2005 and 2004 complies with the requirements of IFRS. Further, we were unable to satisfy ourselves as to the related (i) depreciation expense for the years presented and (ii) the deferred tax balances as of December 31, 2005 and 2004 and deferred tax expense for the years presented.

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

Ernst & Young LLC

June 30, 2006

OJSC “Southern Telecommunications Company”

Consolidated Balance Sheet

As of December 31, 2005

(in thousands roubles)

	Notes	2005	2004 as restated
ASSETS			
Non-current assets			
Property, plant and equipment	**5**	**33,081,215**	33,556,496
Intangible assets and goodwill	**6**	**1,637,489**	1,405,798
Investments in associates	**8**	**578,761**	526,876
Long-term investments	**9**	**45,421**	27,678
Long-term accounts receivable and other financial assets	**10**	**495,064**	566,355
Long-term advances given	**11**	**212,288**	475,421
Total non-current assets		**36,050,238**	36,558,624
Current assets			
Inventories	**12**	**860,130**	1,035,360
Accounts receivable	**13**	**755,722**	1,055,475
Short-term investments		**1,256**	4,266
Prepaid income tax		**131,228**	112,175
Other current assets	**14**	**1,155,939**	1,605,125
Cash and cash equivalents	**15**	**772,082**	463,098
Total current assets		**3,676,357**	4,275,499
TOTAL ASSETS		**39,726,595**	40,834,123
EQUITY AND LIABILITIES			
Equity attributable to equity holders of the parent			
Share capital	**17**	**3,039,255**	3,039,255
Unrealized gain on available-for-sale investments		**5,395**	–
Retained earnings		**6,598,637**	7,685,171
Total equity attributable to equity holders of the parent		**9,643,287**	10,724,426
Minority interest		**12,068**	64,064
Total equity		**9,655,355**	10,788,490
Non-current liabilities			
Long-term borrowings	**18**	**8,454,716**	11,507,660
Long-term finance lease obligations	**19**	**2,071,503**	2,210,188
Pension liabilities	**22**	**868,052**	729,571
Deferred revenue		**377,651**	390,914
Deferred income tax liability	**27**	**992,104**	795,092
Other non-current liabilities		**100,042**	86,213
Total non-current liabilities		**12,864,068**	15,719,638
Current liabilities			
Accounts payable, accrued expenses and advances received	**20**	**3,084,511**	3,733,489
Payables to Rostelecom		**134,906**	134,099
Income tax payable		**375**	69,157
Other taxes payable	**21**	**575,046**	515,389
Dividends payable		**30,067**	82,588
Short-term borrowings	**18**	**2,227,161**	3,419,620
Current portion of long-term borrowings	**18**	**10,141,593**	5,382,728
Current portion of long-term finance lease obligations	**19**	**1,013,513**	988,925
Total current liabilities		**17,207,172**	14,325,995
Total liabilities		**30,071,240**	30,045,633
TOTAL EQUITY AND LIABILITIES		**39,726,595**	40,834,123

General Director ____________ Andreev A. V. *Chief Accountant __________Rusinova T. V.*

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

OJSC "Southern Telecommunications Company"

Consolidated Statement of Operations

For the year ended December 31, 2005

(in thousands roubles, except per share amounts)

	Notes	2005	2004 as restated
Revenues	**23**	**18,773,947**	17,330,815
Wages, salaries, other employee benefits and payroll taxes		**(6,006,300)**	(6,017,511)
Depreciation and amortization	**5,6**	**(3,175,895)**	(2,705,209)
Interconnection charges		**(2,037,419)**	(2,297,209)
Materials, repairs and maintenance, utilities		**(748,531)**	(555,113)
Taxes other than income tax		**(2,622,215)**	(2,495,230)
Provision for impairment of receivables	**13**	**(255,807)**	(70,141)
Loss on disposal of property, plant and equipment		**(167,372)**	(42,835)
Other operating expenses	**24**	**(1,992,485)**	(1,560,774)
Operating profit		**1,767,923**	1,586,793
Share of result of associates	**8**	**126,149**	162,297
Interest expense, net	**25**	**(2,866,329)**	(2,080,944)
Gain (loss) on sale of subsidiaries, associates and other investments	**26**	**(4,057)**	188,398
Foreign exchange gain (loss), net		**133,475**	(57,003)
Loss before income tax		**(842,839)**	(200,459)
Income tax expense	**27**	**(214,360)**	(91,760)
Loss for the year from continuing operations		**(1,057,199)**	(292,219)
Attributable to:			
Equity holders of the parent		**(1,053,292)**	(331,515)
Minority interests		**(3,907)**	39,296
		(1,057,199)	(292,219)
Loss per share			
basic and diluted, for loss for the year attributable to equity holders of the parent	**28**	**(0.27)**	(0.08)

General Director ____________ *Andreev A. V.* *Chief Accountant* __________ *Rusinova T. V.*

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

OJSC "Southern Telecommunications Company"

Consolidated Cash Flow Statement

For the year ended December 31, 2005

(in thousands roubles)

	Notes	2005	2004 as restated
Cash flows from operating activities:			
Loss before income tax		**(842,839)**	(200,459)
Adjustments for:			
Depreciation and amortization	**5,6**	**3,175,895**	2,705,209
Loss on disposal of property, plant and equipment		**167,372**	42,835
Provision for impairment of receivables	**13**	**255,807**	70,141
Provision for obsolescence of inventory and other current assets	**12**	**(749)**	(9,033)
Share of result of associates	**8**	**(126,149)**	(162,297)
Gain/(loss) from investments	**26**	**4,057**	(188,398)
Interest expense, net	**25**	**2,866,329**	2,080,944
Foreign exchange gain (loss), net		**(133,475)**	57,003
Operating cash flows before working capital changes		**5,366,248**	4,395,945
Decrease (increase) in accounts receivable		**41,440**	(337,241)
Decrease (increase) in other current assets		**449,187**	(30,137)
Decrease (increase) in inventories		**168,798**	(72,301)
Increase (decrease) in accounts payable and accrued expenses		**313,335**	(33,839)
Increase in taxes payable other than income tax		**59,657**	159,718
Increase in pension obligations		**138,481**	131,889
Cash flows generated from operations		**6,537,146**	4,214,034
Interest paid		**(2,857,988)**	(1,746,449)
Income tax paid		**(97,028)**	(213,415)
Net cash flows from operating activities		**3,582,130**	2,254,170
Cash flows from investing activities:			
Purchase of property, plant and equipment		**(2,151,452)**	(8,529,643)
Purchase of intangible assets		**(32,313)**	(30,556)
Purchase of Oracle E-Business Suite software		**(179,785)**	(738,203)
Purchase of Amdocs Billing software		**(458,441)**	–
Proceeds from sales of property, plant and equipment		**77,774**	41,826
Purchase of shares in subsidiaries and associates, net of cash acquired		**(26,003)**	(56,191)
Disposal of shares in subsidiaries and associates, net of cash disposed		**39,698**	292,755
Purchase of investments and other financial assets		**(12,553)**	(21,678)
Interest received		**13,126**	11,709
Dividends received		**74,029**	46,931
Net cash flows used in investing activities		**(2,655,920)**	(8,983,050)
Cash flows from financing activities:			
Proceeds from borrowings		**6,203,161**	12,961,130
Repayment of borrowings		**(9,022,777)**	(10,626,639)
Proceeds from debt securities issued		**6,092,657**	4,879,490
Repayment of debt securities		**(1,092,657)**	–
Proceeds from promissory notes		**1,109,819**	2,100,964
Repayment of promissory notes		**(2,157,054)**	(959,703)
Repayment of finance lease obligations		**(1,355,630)**	(725,057)
Repayment of vendor financing obligations		**(305,528)**	(459,919)
Proceeds from other non-current liabilities		**12,123**	31,925
Dividends paid to equity holders of the parent		**(101,340)**	(407,140)
Dividends paid to minority		**–**	(7,186)
Net cash flows from financing activities		**(617,226)**	6,787,865
Net increase in cash and cash equivalents		**308,984**	58,985
Cash and cash equivalents at the beginning of the year		**463,098**	404,113
Cash and cash equivalents at the end of the year		**772,082**	463,098

General Director ____________ *Andreev A. V.* *Chief Accountant* __________*Rusinova T. V.*

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

OJSC “Southern Telecommunications Company”

Consolidated Statement of Changes in Equity

For the year ended December 31, 2005

(in thousands roubles)

		Attributable to equity holders of the parent						
		Share capital						
	Notes	Preference shares	Ordinary shares	Retained earnings	Unrealized gain on available-for-sale investments	Total	Minority interests	Total equity
Balance at December 31, 2003 (as previously stated)		751,302	2,287,953	8,568,685	–	11,607,940	181,909	11,789,849
Corrections of errors		–	–	(248,626)		(248,626)	–	(248,626)
Balance at December 31, 2003 (as restated)	**2**	751,302	2,287,953	8,320,059	–	11,359,314	181,909	11,541,223
Loss for the year (as restated)	**2**	–	–	(331,515)		(331,515)	39,296	(292,219)
Minority interest resulted from consolidation		–	–	–	–	–	17,469	17,469
Dividends to equity holders of parent		–	–	(348,439)	–	(348,439)	–	(348,439)
Minority interests arising on acquisition of subsidiary		–	–	45,066	–	45,066	(72,956)	(27,890)
Disposal of minority interest due to disposal of subsidiaries		–	–	–	–	–	(95,242)	(95,242)
Dividends of subsidiaries to minority shareholders		–	–	–	–	–	(6,412)	(6,412)
Balance at December 31, 2004 (as restated)	**2**	751,302	2,287,953	7,685,171	–	10,724,426	64,064	10,788,490
Loss for the year		**–**	**–**	**(1,053,292)**	**–**	**(1,053,292)**	**(3,907)**	**(1,057,199)**
Dividends to equity holders of parent	**29**	**–**	**–**	**(55,328)**	**–**	**(55,328)**	**–**	**(55,328)**
Unrealized gain on available-for-sale investments		**–**	**–**	**–**	**5,395**	**5,395**	**–**	**5,395**
Acquisition of minority interests in existing subsidiaries		**–**	**–**	**22,086**	**–**	**22,086**	**(48,089)**	**(26,003)**
Balance at December 31, 2005		**751,302**	**2,287,953**	**6,598,637**	**5,395**	**9,643,287**	**12,068**	**9,655,355**

General Director ____________ *Andreev A. V.* *Chief Accountant* __________*Rusinova T. V.*

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

1. General Information

Authorization of Accounts

The accompanying consolidated financial statements are presented by OJSC "Southern Telecommunications Company" (hereafter -"Southern Telecommunications Company" or "Parent"), and its subsidiaries (together - the "Company"), which are incorporated in accordance with the laws of the Russian Federation. The accompanying consolidated financial statements for the year ended December 31, 2005 were authorized for issue by the General Director and the Chief Accountant of Southern Telecommunications Company on June 28, 2006.

The Company

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

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

As of December 31, 2005 open joint-stock company Svyazinvest, a holding company, controlled by the Russian Government owned 50.69% of the Company's ordinary voting stock.

The accompanying consolidated financial statements incorporate the results of operations of Southern Telecommunications Company and its subsidiaries, as detailed in Note 7.

Presentation of Financial Statements

The consolidated financial statements of OJSC "Southern Telecommunications Company" are prepared based on standalone financial statements of the parent and its subsidiaries and associates prepared under unified accounting policy.

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

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

Tariff Setting

Tariffs relating to intercity and local traffic are regulated by the government regulatory body and tariffs for international traffic are regulated by OJSC "Rostelecom".

(in thousands roubles)

1. General Information (continued)

Tariff Setting (continued)

In general, the Company increased tariffs comprised:

	Urban areas, %		Rural areas, %	
Customer Group	**2004**	**2005**	**2004**	**2005**
Residential	33.2	**19.8**	23.0	**22.8**
Corporate clients	26.5	**15.3**	26.5	**15.3**
Non-profit organizations	26.5	**15.3**	26.5	**15.3**

New regulations supporting the implementation of the Federal Law on Communications are effective from January 1, 2006. These regulations affect the principles of provision of fixed line telecommunication services and change licensing requirements to the Company (see also Note 34).

Liquidity and Financial Resources

As of December 31, 2005, the Company’s current liabilities exceeded its current assets by 13,530,815 (December, 31 2004 – 10,050,496). The increase in current liabilities is primarily due to the following.

During 2003 and 2004, the Company significantly enhanced its telecommunication network and acquired telecommunication equipment. Financing primarily came in the form of short-term bank loans, bonds, mid-term vendor financing and finance leases. As a result, the Company’s short and long-term debts increased significantly.

Additionally, as of December 31, 2005 the Company classified 5,000,000 of bonds with maturity date or bondholders’ early redemption rights in 2006 as current liabilities (See Note 18).

In 2005 the Company developed and started to execute the plan for decreasing the working capital deficit which comprised:

- Negotiations with the banks to replace certain short-term bank loans and bank promissory notes by the long term bank loans. As a result the total amount of short-term bank loans and bank promissory notes decreased by 2,038,174 at December 31, 2005 in comparison to December 31, 2004 (see Note 18);
- Refinancing the bank loans to decrease the interest rates. As a result, effective interest rate was decreased approximately by 2% in 2005;
- Decrease of the Company’s capital expenditures from 8,529,643 in 2004 to 2,151,452 in 2005. In 2006 the Company intends to spend approximately 1,500,000 on modernization of its network;
- Cost cutting program;
- Negotiations with contractors to decrease the costs of capital construction and extend the period of payment; and
- Negotiations with Ministry of finance to restructure payables to Vnesheconombank in the amount of 814,306 which are classified as current liabilities as of December 31, 2005.

1. General Information (continued)

Liquidity and Financial Resources (continued)

Through 2006 the Company expects to finance its activities by cash generated from operations and financing obtained from domestic and international lending institutions. As of December 31, 2005, management has secured short-term lines of credit of approximately 12,000,000. Additionally, after the year end the Company has secured about 1,500,000 of short-term and about 500,000 of long-term financing in the form of bank loans and credit lines, also in June 2006 the Board of Directors of the Company has approved the contract for long-term financing in amount about 5,000,000 (see Note 36). Management believes that operational cash flows and financing secured as of the date of these financial statements are adequate to repay the borrowings when they are due in the year 2006.

The accompanying financial statements have been presented on a going concern basis, which contemplates the realization of assets and the settlement of liabilities in the normal course of business. Accordingly, the financial statements do not include any adjustments related to the recoverability and classification of recorded asset amounts or any other adjustments that might result if the Company was either 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. Basis of Presentation of the Financial Statements

Basis of Preparation

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

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

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

The Company has transitioned to IFRS as of January 1, 2003 using the provisions of IFRS 1, “First-time Adoption of International Financial Reporting Standards”, which is effective for periods starting on or after January 1, 2004. IFRS 1 applies to first-time adopters of IFRS including companies that previously applied some, but not all IFRS, and disclosed this fact in its most recent previous financial statements.

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

Basis of Preparation (continued)

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

Management estimates that the carrying value of all of the Company’s property, plant and equipment is broadly comparable to their fair values. However, management engaged an independent appraiser to support these fair values and as a result, the reported carrying amount of property, plant and equipment may be adjusted.

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

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

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

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

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

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

Basis of Preparation (continued)

IAS 1 (revised) “Presentation of Financial Statements” and IAS 27 “Consolidated and Separate Financial Statements”

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

In 2004 the Company acquired shares in CJSC TRK “Foton” and LLC TO “Akcent” for 29,076 (9,120 and 19,391, respectively, inclusive of transaction costs in the amount of 565) and obtained 51% of voting shares in each of these companies (see Note 7). As of December 31, 2004, the Company treated these investments as available-for-sale due to the fact that the control was temporary as the Company intended to sell these subsidiaries in the near future.

In 2005 the previous version of IAS 27 “Consolidated and separate financial statements” was withdrawn and superseded by a substantially revised version which must be applied for accounting periods beginning on or after 1 January 2005. As a result, the previous exemptions from consolidation for investments that are intended to be held on a temporary basis have been removed from IAS 27.

Accordingly, the Company accounted for the acquisition of CJSC TRK “Foton” and LLC TO “Akcent” using the purchase accounting method under IFRS 3 “Business combinations”. The Company determined the fair value of identifiable assets, liabilities and contingences through independent appraisal at the acquisition date. Adjustments were made to 2004 financial statements to reflect the fair value of identifiable assets, liabilities and contingencies and to consolidate the result of operations of CJSC TRK “Foton” and LLC TO “Akcent” from the acquisition date.

As of December 31, 2005 the investments in CJSC TRK “Foton” and LLC TO “Akcent” did not satisfy the criteria to be classified as non-current assets held for sale in accordance with IFRS 5 “Non-current assets held for sale and discontinued operations” as sale was not highly probable within one year.

The effect of the revised policy has decreased net loss for the year ended December 31, 2004 by 2,001 and has increased retained earnings as of Decemer 31, 2004 by the amount of 2,255. For the year 2004 the basic and diluted loss attributable to equity holders of the Parent decreased by the amount of 0.001 Russian Roubles.

IAS 39 “Financial Instruments: Recognition and Measurement” (amended 2004)

The gains and losses on re-measurement of financial assets available-for-sale to fair value are recognized as a separate component of equity. A gain or loss on an available-for-sale financial asset is recognized directly in equity (including a reversal of impairment losses for equity instruments), through the statement of changes in equity, except for impairment losses and foreign exchange gains and losses, until the financial asset is derecognized, at which time the cumulative gain or loss previously recognized in equity is recognized in profit or loss. However, interest calculated using the effective interest method is recognized in profit or loss.

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

Basis of Preparation (continued)

IFRSs and IFRIC Interpretations not yet effective

The Company has not yet applied the following IFRSs and IFRIC Interpretations that have been issued but are not effective as of December 31, 2005:

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

The Company expects that the adoption of the pronouncements listed above will not have significant impact on the Company’s financial statements in the period of initial application.

Management Estimates

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

The management also made significant estimates with regard to those financial statements relating to property, plant and equipment, intangible assets, deferred taxation, provision for impairment of receivables and pension liabilities as discussed in Notes 5, 6, 13, 22 and 27.

Estimation Uncertainty

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

Valuation and useful lives of property, plant and equipment and intangible assets

The most significant estimates with regard to those financial statements relate to the valuation and useful lives of property, plant and equipment and intangible assets as discussed in Notes 5, 6.

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

Estimation Uncertainty (continued)

Impairment of Property, Plant and Equipment

The determination of impairments of property, plant and equipment involves the use of estimates that include, but are not limited to, the cause, timing and amount of the impairment. Impairment is based on a large number of factors, such as changes in current competitive conditions, expectations of growth in the telecommunication industry, increased cost of capital, changes in the future availability of financing, technological obsolescence, discontinuance of service, current replacement costs and other changes in circumstances that indicate an impairment exists. The recoverable amount and the fair values are typically determined using a discounted cash flow method which incorporates reasonable market participant assumptions. The identification of impairment indicators, the estimation of future cash flows and the determination of fair values for assets (or group of assets) requires management to make significant judgments concerning the identification and validation of impairment indicators, expected cash flows, applicable discount rates, useful lives and residual values. Specifically, the estimation of cash flows underlying the value in use of the Company’s property, plant and equipment considers the impact of the new rules and regulations under new provisions of the Federal Law on Communications as discussed in detail in Note 34. As part of this reform, a new price-setting and settlements mechanism among the telecom operators was introduced. Some elements of this mechanism remain unclear and may be subject to additional clarification from the regulators. If this mechanism is changed, this may significantly affect the management’s estimates of the future cash flows and operating results and, consequently, the amount of potential impairment of the Company’s property, plant and equipment.

Impairment of Goodwill

The Company determines whether goodwill and intangible assets not yet available for use are impaired at least on an annual basis. This requires an estimation of the value in use of the cash-generating units to which the goodwill is allocated. Estimating the value in use requires the Company to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows. The carrying amount of goodwill at December 31, 2005 was 15,218 (2004: 15,218) and carrying amount of intangible assets not yet available for use at December 31, 2005 was 1,539,656 (2004: 1,274,159). More details are provided in Note 6.

Correction of an Error

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

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

Correction of an Error (continued)

Accounting for Deferred Income Taxes

In 2005 the Company corrected tax balances of property, plant and equipment as of December 31, 2004 and 2003. As a result the Company made adjustments to the amount of deferred tax liabilities as of December 31, 2004 and 2003 and deferred income tax benefit for the year ended December 31, 2004.

The effect of correction of tax balances of property, plant and equipment has decreased net loss for the year ended December 31, 2004 by 238,431. Deferred tax liabilities of acquired subsidiaries recognized in 2004 due to revised accounting policy has increased deferred tax liabilities as of December 31, 2004 by 12,721. As a result the amount of retained earnings as of Decemer 31, 2004 has deacreased by the total amount of 207,489.The amount of retained earnings as of Decemer 31, 2003 has deacreased by the amount of 433,199.

For the 2004 year the basic and diluted loss attributable to equity holders of the Parent decreased by the amount of 0.060 Russian Roubles due to the effect of correction of tax balances and due to the effect of revised accounting policy. The deffered tax liability at January 1, 2004 and December 31, 2004 was restated as presented in the table below.

Accounting for Employee Benefits

In 2005 the Company determined and presented its obligations existing under the defined benefit plans in accordance with IAS 19, “Employee Benefits”. The Company engaged an actuary to perform a valuation of the pension obligations and recorded the defined benefit obligation as of December 31, 2005 and made adjustments to the comparatives as of December 31, 2003 and 2004.

The effect of presenting the obligations existing under the defined benefit plans in accordance with IAS 19 has deacreased net loss for the year ended December 31, 2004 by 95,110 and retained earnings as of Decemer 31, 2004 by the amount of 279,429. For the year 2004 the basic and diluted loss attributable to equity holders of the Parent increased by the amount of 0.019 Russian Roubles. The effect of presenting the obligations existing under the defined benefit plans in accordance with IAS 19 has changed net pension liability at January 1, 2004 and December 31, 2004 as presented in the table below.

Presenting the obligations existing under the defined benefit plans in accordance with IAS 19 has resulted in additional disclosures being added for the year ended December 31, 2004.

The effect of presenting the obligations existing under the defined benefit plans in accordance with IAS 19 has increased the retained earnings as of Decemer 31, 2003 by 184,319 and correction of tax balances of property, plant and equipment has decreased the retained earnings as of December 31, 2003 by 433,199. The total effect on retained earnings as of December 31, 2003 comprised 248,880.

(in thousands roubles)

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

Reclassifications

The Company made the reclassifications to the 2004 financial statements to conform to the 2005 presentation.

	As previously reported	Correction of errors	Change in accounting policy	Reclassifica-tions	Total adjustments	As restated
Consolidated balance sheet as of December 31, 2004						
Property, plant and equipment	**33,553,806**	–	2,690	–	2,690	**33,556,496**
Intangible assets and goodwill	**1,343,609**	–	62,189	–	62,189	**1,405,798**
Accounts receivable	**1,053,732**	–	1,743	–	1,743	**1,055,475**
Short-term investments	**38,049**	–	(33,783)	–	(33,783)	**4,266**
Prepaid income tax	**–**	–	–	112,175	112,175	**112,175**
Other current assets	**1,874,814**		1,589	(271,278)	(269,689)	**1,605,125**
Cash and cash equivalents	**463,056**	–	42	–	42	**463,098**
Total assets	**40,958,756**	**–**	**34,470**	**(159,103)**	**(124,633)**	**40,834,123**
Pension liabilities	**(1,009,000)**	279,429			279,429	**(729,571)**
Deferred income tax liability	**(587,603)**	(194,768)	(12,721)		(207,489)	**(795,092)**
Accounts payable, accrued expenses and advances received	**(3,731,115)**	–	(2,374)		(2,374)	**(3,733,489)**
Short-term borrowings	**(3,816,150)**	–	–	396,530	396,530	**(3,419,620)**
Current portion of long-term borrowings	**(5,145,301)**	–	–	(237,427)	(237,427)	**(5,382,728)**
Total liabilities	**(30,274,302)**	**84,661**	**(15,095)**	**159,103**	**228,669**	**(30,045,633)**
Minority interest	**(46,944)**	–	(17,120)	–	(17,120)	**(64,064)**
Retained Earnings as of December 31, 2004	**7,598,255**	**84,661**	**2,255**		**86,916**	**7,685,171**

(in thousands roubles)

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

Reclassifications (continued)

	As previously reported	Correction of errors	Change in accounting policy	Reclassifica-tions	Total adjustments	As restated
Consolidated Statement of Operations for the year ended December 31, 2004						
Revenues	**17,322,808**	–	8,007	–	8,007	**17,330,815**
Wages, salaries, other employee benefits and payroll taxes	**(6,112,621)**	95,110	–		95,110	**(6,017,511)**
Depreciation and amortization	**(2,699,167)**	–	(6,042)	–	(6,042)	**(2,705,209)**
Other operating expenses	**(1,544,181)**	–	(3,767)	(12,826)	(16,593)	**(1,560,774)**
Bank fees	**(12,826)**	–	–	12,826	12,826	**–**
Deferred income tax	**(56,834)**	238,431	–	–	238,431	**181,597**
Current income tax	**(272,760)**	–	(597)	–	(597)	**(273,357)**
Gain (loss) on sale of subsidiaries, associates and other investments	**184,346**	–	4,052	–	4,052	**188,398**
Loss for the year ended December 31, 2004	**(667,057)**	**333,541**	**2,001**	**–**	**335,542**	**(331,515)**
Basic and diluted loss per share attributable to equity holders of the parent, Russian Roubles	**(0.17)**	0.08	0.01	–	0.09	**(0.08)**

3. Summary of Significant Accounting Policies

3.1 Principles of Consolidation

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

Subsidiaries

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

3. Summary of Significant Accounting Policies (continued)

3.1 Principles of Consolidation (continued)

Acquisition of Subsidiaries

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

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

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

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

Acquisition of Minority Interest in Subsidiaries

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

3.2 Investments in Associates

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

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

3. Summary of Significant Accounting Policies (continued)

3.3 Investments

The Company’s investments are classified as either loans and receivables or available-for-sale investments, as appropriate. When investments are recognised initially, they are measured at fair value plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs. The Company determines the classification of its investments after initial recognition. All purchases and sales of investments are recognised on the settlement date, which is the date that the investment is delivered to or by the Company.

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

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

(a) those that the entity intends to sell immediately or in the near term, which shall be classified as held for trading, and those that the entity upon initial recognition designates as at fair value through profit or loss;

(b) those that the entity upon initial recognition designates as available for sale; or

(c) those for which the holder may not recover substantially all of its initial investment, other than because of credit deterioration, which shall be classified as available for sale.

Such assets are carried at amortised cost using the effective interest method. Gains and losses are recognised in income when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

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

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

3. Summary of Significant Accounting Policies (continued)

3.4 Accounting Policies, Changes in Accounting Estimates and Errors

Change in Accounting Policies

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

The Company applies the change in accounting policies retrospectively and adjusts the opening balance of each affected component of equity for the earliest prior period presented and other comparative amounts disclosed for each prior period presented as if the new accounting policy had always been applied.

Changes in Accounting Estimates

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

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

Prior Period Errors

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

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

3.5 Foreign Currency Transactions

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

(in thousands roubles)

3. Summary of Significant Accounting Policies (continued)

3.5 Foreign Currency Transactions (continued)

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

The exchange rates as of December 31 were as follows:

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

3.6. Property, Plant and Equipment

3.6.1 Property, plant and equipment

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

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

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

(in thousands roubles)

3. Summary of Significant Accounting Policies (continued)

3.6. Property, Plant and Equipment (continued)

3.6.2 Depreciation and Useful Life

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

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

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

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

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

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

3.6.3 Construction in Progress

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

3. Summary of Significant Accounting Policies (continued)

3.6. Property, Plant and Equipment (continued)

3.6.4 Assets Received Free of Charge

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

Equipment contributions that will not generate any future economic benefits for the Company are not recognized.

3.7 Intangible Assets

3.7.1 Goodwill

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

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

Each unit or group of units to which the goodwill is so allocated:

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

Impairment is determined by assessing the recoverable amount of the cash-generating unit (group of cash-generating units), to which the goodwill relates. Where the recoverable amount of the cash-generating unit (group of cash-generating units) is less than the carrying amount, an impairment loss is recognised. Where goodwill forms part of a cash-generating unit (group of cash-generating units) and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained. An impairment loss recognized for goodwill is not reversed in a subsequent period.

3. Summary of Significant Accounting Policies (continued)

3.7 Intangible Assets (continued)

3.7.2 Licenses

License costs represent either an allocation of the purchase price to licenses acquired in business combinations or the payments made to government organizations to receive the licenses. License costs are capitalized and amortized on a straight-line basis over their expected useful lives from the date operations commenced in the license area.

The Company recognized the cost of television broadcasting licenses at fair value based on independent appraisal report.

Following initial recognition, licenses are carried at cost less any accumulated amortisation and any accumulated impairment losses.

3.7.3 Software and Other Intangible Assets

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

3.7.4 Useful Life and Amortization of Intangible Assets

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

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

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

The cost of licenses and software is depreciated on a straight-line basis over the estimated useful life equal to the term of the licenses or the right to use the software. Useful life of other intangible assets is approximately 10 years.

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

3. Summary of Significant Accounting Policies (continued)

3.8 Borrowing Costs

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

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

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

3.9 Leases

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

Leases where the lessor retains substantially all the risks and rewards of ownership of the asset are classified as operating leases. The Company acted as a lessee under the finance and operating leases.

3.9.1 Finance Leases

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

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

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

3. Summary of Significant Accounting Policies (continued)

3.9 Leases (continued)

3.9.2 Operating Leases

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

3.10 Inventories

Inventories are recorded at the lower of cost and net realizable value. The cost of inventory is determined on the weighted average basis. Net realizable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and the estimated costs necessary to make the sale. The cost of inventory may have to be reduced to its realizable value if it has become damaged, is wholly or partly obsolete or if its selling price has declined. The Company analyzed the evidence of these conditions at the end of the period and created a provision for obsolescence.

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

3.11 Advances Given

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

3.12 Financial Instruments

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

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

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

3. Summary of Significant Accounting Policies (continued)

3.12 Financial Instruments (continued)

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

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

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

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

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

3.13 Cash and Cash Equivalents

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

3.14 Accounts Receivable and Provision for Impairment of Receivables

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

Provision for impairment of receivables is created on the basis of the historical pattern of collections of accounts receivable and specific analysis of recoverability of significant accounts.

Provision for impairment is also created for other accounts receivable on the basis of the assessment of the Company’s ability to collect the debts.

Provision for impairment is recognized in the consolidated statement of operations. The carrying amount of current trade receivables is a reasonable approximation of their fair value.

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

3. Summary of Significant Accounting Policies (continued)

3.15 Non-current Assets Held for Sale and Discontinued Operations

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

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

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

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

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

3.16 Loans Given

Loans given are recognized at the amortized cost, using the effective interest method less provision for impairment or uncollectibility. Loans given are recorded as the non-current assets unless the repayment is expected within 12 months after the balance sheet date.

3.17 Loans and Borrowings Received

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

3.18 Employee Benefits

3.18.1 Unified Social Tax

Under provisions of the Russian legislation, social contributions are made through a unified social tax ("UST") calculated by the Company by the application of a regressive rate (from 17% to 26%) 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 20% 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.

3. Summary of Significant Accounting Policies (continued)

3.18 Employee Benefits (continued)

3.18.2 Pension Plans and Post-Employment Benefits

Post-employment benefit plans include defined contribution plans and defined benefit plans.

A defined contribution plan is a post-employment benefit plan under which the Company's obligation 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. In this case actuarial and investment risks fall on the Company.

The Company provides pension coverage under post-employment defined benefit plans in accordance with collective bargaining agreements and internal regulations on additional pension benefits. The majority of the Company’s employees are eligible to participate in such post-employment benefit plans based upon a number of factors, including years of service, age, and compensation.

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

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

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

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

3.19 Income Taxes

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

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

3. Summary of Significant Accounting Policies (continued)

3.19 Income Taxes (continued)

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

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

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

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

A deferred tax asset is recorded only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised.

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

Deferred tax assets and liabilities are not discounted.

3.20 Shareholders’ Equity

3.20.1 Share Capital

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

3.20.2 Dividends

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

3. Summary of Significant Accounting Policies (continued)

3.21 Minority Interest

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

3.22 Revenue Recognition

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

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

3.22.1 Revenue from Customers

The Company categorizes the revenue sources in thirteen major categories:

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

Long distance calls (domestic and international)

Long distance services depend on time, duration and destination of the call, type of service used, subscriber category and the applied rate plan. Customers of the Company use the service via fixed telephones and public pay-phones. 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.

3. Summary of Significant Accounting Policies (continued)

3.22 Revenue Recognition (continued)

Local telephone calls

Revenue from the local telephone services comprises subscription fee and also depends on the duration of the telephone connection if time-driven billing scheme is applied. If fixed payment scheme is applied then revenue depends on the subscription fee only. Customers of the Company use the service via fixed telephones and the service could be accessed by means of pay-phones. The Company recognizes revenues related to the monthly fees for local services in the month the service is provided to the subscriber.

Installation and connection fees

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

Documentary services

Telegraph services include telegram transmissions and other wire line data transmission services. The Company recognizes revenues from documentary services in the period when the services are rendered.

Cellular services

Major revenues from cellular services arise from airtime 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 provides Radio and TV broadcasting services through its wireline radio broadcasting network. The revenues comprise monthly fees from subscribers and installation fees for wireline radio sets. The Company recognizes the revenues related to radio broadcasting and TV services in the period when the services are rendered.

Data transfer and telematics services

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

3. Summary of Significant Accounting Policies (continued)

3.22 Revenue Recognition (continued)

New services

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

Rent of telephone channels

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

Services to local operators

Services to local service providers include two different groups. The first type of services is rendered to the Company’s partners for termination of long-distance traffic of its operators-partners in the network of the Company.

The second type of services is rendered to interconnected telecom operators that transfer local, intercity and international traffic of their customers via the Company’s network.

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

The Company recognizes revenues from services to local 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 stations, that belong to the Company, from the rent of direct lines and local junctions, as well as subscription fees for wired-radio outlets. The Company recognizes revenues related to other services in the period when the services are rendered.

Other revenues

Other revenues primarily consist of revenues received from manufacturing of the telecommunication equipment and its technical support, construction services, sales of products, recreational services, rent of assets, agency fees, services provided by auxiliary units.

3. Summary of Significant Accounting Policies (continued)

3.23 Earnings per Share

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

The Company’s preference shares are considered participating equity instruments for the purpose of earnings per share calculations (see Note 28).

3.24 Provisions

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

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

3.25 Contractual Commitments

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

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

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

3.26 Contingent Assets and Contingent Liabilities

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

3. Summary of Significant Accounting Policies (continued)

3.26 Contingent Assets and Contingent Liabilities (continued)

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

3.27 Related Party Transactions

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

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

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

3.28 Events After the Balance Sheet Date

The Company adjusts the amounts recognized in its financial statements to reflect adjusting events after the balance sheet date. Events require an entity to adjust the amounts recognized in its financial statements are caused by favorable and unfavorable outcomes of conditions that existed at the balance sheet date and change in management estimates subject to uncertainties which was used for accounting of a number of business activities.

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

(in thousands roubles)

4. Segment Information

The Company provides the wireline telecommunication services, on the territory of the Southern regions of the Russian Federation. The Company's structure is based on territorial units which service the corresponding parts of the Company's network. The Company's management considers that the Company operates in one geographical and business segment and evaluates performance and makes investment and strategic decisions based upon a review of profitability for the Company as a whole.

5. Property, Plant and Equipment

	Land, buildings and constructions	Switches and transmission devices	Construction in progress and equipment for installation	Vehicles and other	Total
Cost					
At December 31, 2003	**10,216,605**	**10,667,016**	**3,634,022**	**1,722,878**	**26,240,521**
Additions	–	–	12,061,223	–	12,061,223
Put in operation	5,866,134	3,788,692	(10,683,602)	1,028,776	–
Additions due to acquisition of subsidiaries	–	–	–	2,690	2,690
Disposals	(75,039)	(368,646)	(9,206)	(90,220)	(543,111)
Disposals due to sale of subsidiaries	(86,358)	(71,645)	(58,634)	(13,096)	(229,733)
At December 31, 2004 as restated	**15,921,342**	**14,015,417**	**4,943,803**	**2,651,028**	**37,531,590**
Additions	–	–	2,964,176	–	2,964,176
Put in operation	2,691,854	2,025,047	(5,200,994)	484,093	–
Disposals	(234,129)	(401,924)	(83,513)	(106,707)	(826,273)
Disposals due to sale of subsidiaries	(49,720)	(107)	–	(12,465)	(62,292)
At December 31, 2005	**18,329,347**	**15,638,433**	**2,623,472**	**3,015,949**	**39,607,201**
Accumulated Depreciation					
At December 31, 2003	**(432,824)**	**(1,068,189)**	**–**	**(278,051)**	**(1,779,064)**
Charge for the year (as restated)	(722,385)	(1,661,245)	–	(306,662)	(2,690,292)
Disposals (as restated)	66,372	319,252	–	72,827	458,451
Disposals due to sale of subsidiaries	12,475	14,543		8,793	35,811
At December 31, 2004 (as restated)	**(1,076,362)**	**(2,395,639)**	**–**	**(503,093)**	**(3,975,094)**
Charge for the year	(793,505)	(1,998,151)	–	(356,704)	(3,148,360)
Disposals	162,917	326,915	–	91,294	581,126
Disposals due to sale of subsidiaries	5,231	105	–	11,006	16,342
At December 31, 2005	**(1,701,719)**	**(4,066,770)**	**–**	**(757,497)**	**(6,525,986)**
Net book value as of December 31, 2003	**9,783,781**	**9,598,827**	**3,634,022**	**1,444,827**	**24,461,457**
Net book value as of December 31, 2004, as restated	**14,844,980**	**11,619,778**	**4,943,803**	**2,147,935**	**33,556,496**
Net book value as of December 31, 2005	**16,627,628**	**11,571,663**	**2,623,472**	**2,258,452**	**33,081,215**

(in thousands roubles)

5. Property, Plant and Equipment (continued)

The net book value of plant and equipment held under finance leases at December 31, comprised:

	2005	**2004 as restated**
Switches and transmission devices	**3,627,225**	3,113,475
Vehicles and other	**34,538**	17,006
Construction in progress and equipment for installation	**820,920**	834,502
Total net book value of plant and equipment held under finance leases	**4,482,682**	3,964,983

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

The net book value of property, plant and equipment, which were received on vendor financing terms, comprised as of December 31, 2005 to 691,188 (2004 – 722,122) (see Note 16).

In 2005, the Company increased construction in progress by the amount of capitalized interest totaling 323,225 (2004 – 579,106). Capitalization rate in 2005 was 13.3% (2004 – 14.9%).

Construction in progress and equipment for installation include cable and construction materials in the amount of 67,362 as of December 31, 2005 (2004 – 68,515).

Bank borrowings are secured by properties with the carrying value as of December, 31 2005 of approximately 9,014,939 (2004 – 12,280,636) (see Note 18).

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

6. Intangible Assets and Goodwill

	Goodwill	**Licenses**	**Software**	**Other**	**Total**
Cost					
At December 31, 2003	**–**	**5,177**	**590,080**	**2,148**	**597,405**
Additions	–	723	768,036	–	768,759
Additions due to acquisition of subsidiaries	15,218	53,013	–	–	68,231
At December 31, 2004, as restated	**15,218**	**58,913**	**1,358,116**	**2,148**	**1,434,395**
Additions	–	1,255	257,915	56	259,226
At December 31, 2005	**15,218**	**60,168**	**1,616,031**	**2,204**	**1,693,621**
Accumulated amortization					
At December 31, 2003	–	(3,359)	(9,419)	(902)	(13,680)
Charge for the year (as restated)	–	(7,542)	(6,996)	(379)	(14,917)
At December 31, 2004, as restated	**–**	**(10,901)**	**(16,415)**	**(1,281)**	**(28,597)**
Charge for the year	–	(12,748)	(14,408)	(379)	(27,535)
At December 31, 2005	**–**	**(23,649)**	**(30,823)**	**(1,660)**	**(56,132)**
Net book value at December 31, 2003	**–**	**1,818**	**580,661**	**1,246**	**583,725**
Net book value at December 31, 2004, as restated	**15,218**	**48,012**	**1,341,701**	**867**	**1,405,798**
Net book value at December 31, 2005	**15,218**	**36,519**	**1,585,208**	**544**	**1,637,489**

6. Intangible Assets and Goodwill (continued)

Oracle E-Business Suite (OEBS)

As of December 31, 2005 software includes OEBS software with a gross book value of 947,691 (2004 – 746,645), including interest capitalized of 143,223 (2004 – 104,769) and implementation costs totaling 259,172 (2004 – 96,580). Capitalization rate in 2005 was 15% (2004 – 15%). In accordance with the supply contract, the Company acquired non-exclusive licenses for 10,745 users of E-business Suite 2003 Professional. The Company started the pilot operation of OEBS in relation to the module for accounting for non-current assets in Kubanelektrosvyaz, Elektrosvyaz of the Republic of Adygeya and Head Office on November 01, 2005.

OEBS software is expected to be fully implemented by 2009.

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

Amdocs Billing Suite

As of December 31, 2005 software also includes Amdocs Billing Suite software with a gross book value of 591,965 (2004 – 527,487), including the implementation costs totaling 64,478 (2004 – nil). This software was purchased for the purpose of the implementation of unified billing system. The project of implementation of the unified billing system is expected to last 4-5 years.

Amdocs Billing Suite software was supplied by LLC IBM Eastern Europe/Asia in December 2004, in exchange for zero coupon 18 promissory notes for the total amount of 648,810. As of June 1, 2006 the Company fully repaid the promissory notes issued.

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

Licenses

The licenses mainly included television broadcasting licenses with the net book value of 34,973 (2004 – 46,970) at December 31. The Company acquired these licenses through the acquisition in 2004 of the share in subsidiaries LLC TO “Akcent” and CJSC TRC “Photon”. The fair value of television broadcasting licenses at the subsidiaries purchase date is based on valuation performed by independent appraiser. The remaining useful lives of licenses are approximately 3 years.

Amortization charge for 2005 in the amount of 27,535 (2004 – 14,917) is included into the line Depreciation and Amortization of Consolidated Statement of Operations.

(in thousands roubles)

6. Intangible Assets and Goodwill (continued)

Impairment testing of goodwill

Goodwill acquired through business combinations has been allocated to LLC TO "Akcent" as the cash-generating unit for impairment testing.

The recoverable amounts of LLC TO "Akcent" has been determined based on a value in use calculation using cash flow projections based on financial budget approved by senior management. The budget was prepared based on the management intention to sell Company's share in LLC TO "Akcent" in the year 2007. The discount rate applied to cash flow projections is 14% (2004: 14%).

Carrying amount of goodwill allocated to LLC TO "Akcent" is equal to 15,218 (2004 – 15,218). As of December 31, 2005 no impairment was identified by the Company after the testing of LLC TO "Akcent" for impairment.

Impairment test of intangible assets not yet available for use

The Company performed impairment tests of intangible assets not yet available for use. These assets represent cost of Oracle E-Business Suite and Amdocs Billing Suite totaling 1,539,656 at December 31, 2005 (as at December 31, 2004 – 1,274,159). As at December 31, 2005 no impairment was identified.

7. Consolidated Subsidiaries and Joint Venture

Subsidiaries comprised the following at December 31:

		Ownership,%		Voting Shares	
Subsidiary	**Main activity**	**2005**	**2004 as restated**	**2005**	**2004 as restated**
CJSC "Armavirskiy Zavod Svyazi"	Cable production	**100**	100	**100**	100
CJSC "Yugsvyazstroy"	Construction services	**100**	100	**100**	100
OJSC "Orbita" Recreational House"	Recreational services	**100**	100	**100**	100
OJSC "Stavtelecom named after V.I.Kuzminov" (OJSC "Stavtelecom")	Local, intercity communications, data transfer	**100**	81	**100**	81
LLC "Intmashservice"	Communication facilities repairs and support	**100**	100	**100**	100
LLC "Faktorial- 99"	Informational and commercial agency activity	**100**	100	**100**	100
LLC "YuTC-Finance"	Financial Service	**100**	100	**100**	100
CJSC TRC "Photon"	Commercial TV and radio broadcasting services	**51**	51	**51**	51
LLC TO "Akcent"	Commercial TV and radio broadcasting services	**51**	51	**51**	51
CJSC "CMTO"	Supply of materials	**–**	100	**–**	100

(in thousands roubles)

7. Consolidated Subsidiaries and Joint Venture (continued)

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

In 2004 in accordance with the decisions of the Company's Board of Directors the Company increased its share in OJSC "Stavtelecom", the fixed line operator in Stavropol region, up to 81%. The difference between the cost of the additional interest in the subsidiary and the minority interest's share of the assets and liabilities amounted to 45,066 was reflected in the consolidated retained earnings as of December 31, 2004.

As a result of OJSC "Stavtelecom" own stock redemption for 26,003 the Company increased its share in OJSC "Stavtelecom" up to 100%. The difference between the cost of the additional interest in the subsidiary and the minority interest's share of the assets and liabilities amounted to 22,086 was reflected in the consolidated retained earnings as of December 31, 2005.

Disposal of shares in subsidiaries for 2005 is presented below:

Name	Main activity	Carrying amount of net assets disposed	Proceeds from sale	Sale/disposal of share in equity on the date of transaction, %
CJSC "CMTO"	Supply of materials	49,772	45,010	100
Total			**45,010**	

In April 2005 in accordance with the decision of the Board of Directors dated December 22, 2004 the Company sold a 100 % stake in CJSC "CMTO". Carrying amount of net assets as of the date of disposal was 49,772. Costs related to disposal amounted to 1,350 (see Note 26).

Joint Venture with CJSC "Westelcom"

The Company owns 50% of the stock of the joint venture with CJSC "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. The Company's share of the assets, liabilities, revenue and expenses of the joint venture are included in the consolidated financial statements under proportionate consolidation method.

(in thousands roubles)

8. Investments in Associates

Investments in associates comprised the following at December 31:

		2005		2004 as restated	
Associate	**Activity**	**Voting shares**	**Carrying value**	**Voting shares**	**Carrying value**
CJSC "Volgograd GSM"	Cellular services (GSM)	**50%**	**545,049**	50%	462,036
OJSC "TeleRoss Kubanelektrosvyaz"	Telecommunication services	**50%**	**17,186**	50%	15,309
CJSC "Stavropol cellular communications"	Cellular services (AMPS-800 MHz)	**50%**	**10,937**	50%	13,156
CJSC "TeleRoss-Volgograd"	Local and intercity communication services	**50%**	**3,457**	50%	3,851
CJSC "ZanElCom"	Support of regional network IT systems	**45%**	**17**	45%	28
LLC "Yug-Giprosvyaz"	Project engineering	**24%**	**–**	24%	26,239
CJSC "IR Telekinocompaniya"	Commercial TV and radio broadcasting services	**24%**	**–**	24%	–
CJSC "Karachayevo-CherkesskTeleSot"	Cellular communications, GSM-900 MHz	**20%**	**2,115**	20%	6,095
CJSC "Kabardino-Balkar GSM"	Cellular communications, GSM-900 MHz	**20%**	**–**	20%	–
OJSC "Stavropolskoe commercheskoe televidenie"	Creation and development of paid broadcast TV	**–**	**–**	27%	162
Total			**578,761**		526,876

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

The Company has investments in the following associates whose net assets were negative at December 31:

			Net assets as of December 31	
Name	**Activity**	**Voting share, %**	**2005**	**2004**
LLC "Yug-Giprosvyaz"	Project engineering	24%	**(2,645)**	109,328
CJSC "IR Telekinocompaniya"	Commercial TV and radio broadcasting services	24%	**(489)**	(598)
CJSC "Kabardino-Balkar GSM"	Cellular communications, GSM-900 MHz	20%	**(2,134)**	(883)

The carrying value of investments in associates shown in these consolidated financial statements is equivalent to the Company's share in the net assets of the associated company, except for investments in LLC "Yug-Giprosvyaz", CJSC "IR Telekinocompaniya" and CJSC "Kabardino-Balkar GSM". For these latter associates the carrying amounts of the investments were reduced to zero considering that such associates reported accumulated losses exceeding the cost of the respective investments.

(in thousands roubles)

8. Investments in Associates (continued)

Disposal of shares in associates for 2005 is presented below:

Associate	**Main activity**	**Carrying value of investment in associate**	**Sale/disposal of share in equity on the date of transaction, %**	**Proceeds from sale**
OJSC “Stavropolskoe commercheskoe televidenie”	Creation and development of paid broadcast TV	153	27%	192
Total		**153**		**192**

Gain/(loss) from sale of shares in associates is presented in Note 26.

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

	2005	**2004 as retstated**
Investments in associates at January 1	**526,876**	409,404
Share of income net of income tax and dividends received	**52,038**	117,472
Sale of associates	**(153)**	–
Investments in associates at December 31	**578,761**	526,876

In 2005 the share of income net is presented net of income tax in amount of 34,687 (2004 – 64,143). The dividends received in 2005 comprised 74,029 (2004 - 44,825).

The following table illustrates summarised financial information of the associates:

Associate	**Voting shares**	**Assets**	**Liabilities**	**Revenues**	**Net income/(loss)**
2005					
CJSC “Stavropol cellular communications”	**50%**	**24,995**	**(3,162)**	**6,241**	**(4,438)**
LLC “Yug-Giprosvyaz”	**24%**	**224,102**	**(226,747)**	**200,361**	**(18,328)**
OJSC “TeleRoss Kubanelektrosvyaz”	**50%**	**35,031**	**(659)**	**41,770**	**12,708**
CJSC “Volgograd GSM”	**50%**	**1,930,551**	**(840,453)**	**1,139,237**	**259,568**
CJSC “Karachayevo-CherkesskTeleSot”	**20%**	**31,719**	**(21,144)**	**33,197**	**(19,898)**
CJSC “TeleRoss-Volgograd”	**50%**	**7,635**	**(721)**	**3,826**	**15**
Other		**20,080**	**(33,175)**	**8,446**	**(5,773)**
2004					
CJSC “Stavropol cellular communications”	50%	30,574	(4,303)	10,938	(5,121)
LLC “Yug-Giprosvyaz”	24%	356,449	(247,121)	525,635	93,646
OJSC “TeleRoss Kubanelektrosvyaz”	50%	32,603	(1,985)	34,415	8,340
CJSC “Volgograd GSM”	50%	1,563,523	(639,451)	1,140,341	291,424
CJSC “Karachayevo-CherkesskTeleSot”	20%	36,688	(6,213)	119,369	22,308
CJSC “TeleRoss-Volgograd”	50%	12,755	(5,053)	13,034	1,088
Other		14,049	(20,956)	7,735	(5,442)

(in thousands roubles)

9. Long-Term Investments, net

Available for sale investments were presented by shares in the following entities as of December 31:

	2005		2004 as retstated	
Company	Ownership interest	Carrying value	Ownership interest	Carrying value
OJSC "BETO"	**0.15%**	**26,302**	0.15%	26,302
OJSC "Informatsionnye Tehnologii Svyazy" (OJSC "Svyazintech")	**11.00%**	**12,591**	–	–
OJSC "Sberbank RF"	**2.00%**	**5,401**	2.00%	6
CJSC "RusleasingSvyaz"	**3.65%**	**1,424**	3.65%	1,424
OJSC "Aksai"	–	–	0.20%	86
CJSC "Maikopbank"	–	–	3.00%	–
LLC "Moscow Insurance Company"	–	–	0.04%	–
Other		**1,990**		2,233
Impairment provision		**(2,287)**		(2,373)
Total investment available-for-sale, net		**45,421**		27,678

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

Purchase of share in OJSC "Informatsionnye Tehnologii Svyazy" (OJSC "Svyazintech")

In accordance with the resolution of the BOD meeting held on February 14, 2005 the Company acquired 11% of shares in OJSC "Svyazintech" for 16.5. In August 2005 the Company purchased additional newly issued 1,257,454 ordinary shares of OJSC "Svyazintech" for 12,575 in order to maintain its 11% interest.

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

In accordance with the resolution of the BOD meeting held on November 30, 2005 the Company has written-off its share in OJSC "Aksai" using previously created impairment provision since it was not possible to determine current location of the investee.

In accordance with the resolution of the BOD meeting held on November 11, 2005 the Company has sold its share in CJSC "Maikopbank" for 4. Carrying amount of investment as of the date of disposal equaled to nil.

In June 2005 the Company has sold its share in LLC "Moscow Insurance Company" for 35. Carrying amount of investment as of the date of disposal equaled to nil.

(in thousands roubles)

10. Long-Term Accounts Receivable and Other Assets

Long-term accounts receivable and other assets comprised the following as of December 31:

	2005	2004 as retstated
VAT recoverable	**359,886**	436,585
Constructed assets held for sale	**107,032**	83,291
Deferred bank charges	**12,825**	25,653
Long-term loans given to employees	**11,424**	18,646
Long-term loans given to legal entities	**3,897**	2,180
Total	**495,064**	566,355

Long-term loans given to employees are accounted at amortized cost using the effective interest rate of 21% as of December 31, 2005 (2004 – 22%).

11. Long-Term Advances Given

As of December 31 long-term advances given to suppliers of equipment comprised the following:

	2005	2004 as retstated
Advances given for capital construction	**98,768**	379,094
Acquisition and implementation of Oracle E-Business Suite software (Note 6)	**113,520**	96,327
Total	**212,288**	475,421

12. Inventories

Inventories comprised the following as of December 31:

	2005	2004 as retstated
Cable, materials and spare parts for telecommunications equipment	**297,915**	354,781
Materials, fuel and instruments	**211,582**	293,238
Finished goods and goods for resale	**91,676**	98,864
Other inventories	**266,051**	296,321
Provision for inventory obsolescence	**(7,094)**	(7,844)
Total	**860,130**	1,035,360

Provision for inventory obsolescence is presented as other operating expenses in the Consolidated Statement of Operations.

As of December 31, 2005 no inventories have been pledged as security for borrowings (2004 – nil).

(in thousands roubles)

13. Accounts Receivable

Accounts receivable comprised the following as of December 31:

	2005	2004 as retstated
Trade receivables – telecommunication services	**1,321,056**	1,476,265
Trade receivables – other	**140,543**	53,448
Provision for impairment of receivables	**(705,877)**	(474,238)
Total	**755,722**	1,055,475

Trade Accounts receivable for telecommunication services were due from the following major customer groups as of December 31:

	2005	2004 as retstated
Corporate customers	**249,798**	231,125
Residential customers	**422,221**	483,220
Government customers	**95,178**	134,387
Tariff compensation from the state budget	**553,859**	627,533
Total	**1,321,056**	1,476,265

The debt of state budget with regard to the compensation of the amounts due from privileged amounted to 38% of the total trade accounts receivable as of December 31, 2005 (2004 – 41%). The Company collected receivable for tariff compensation in the amount of 101,236 from the state budget in 2005, including 73,340 in a judicial proceeding.

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

	2005	2004, as restated
Balance at January 1	**474,238**	419,158
Charge for the year	**255,807**	70,141
Trade receivables written off	**(24,168)**	(15,061)
Balance at December 31	**705,877**	474,238

The impairment charge for 2005 in the amount of 255,807 (2004 – 70,141) was recognized in the Consolidated Statement of Operations.

14. Other Current Assets

Other current assets comprised the following as of December 31:

	2005	2004, as restated
VAT receivable	**804,300**	1,244,656
Deferred expenses	**116,733**	154,564
Prepayments and advance payments	**80,438**	104,704
Tax claims receivable	**67,704**	3,586
Other prepaid taxes	**12,109**	14,253
Settlements with personnel	**5,616**	12,502
Short-term loans given	**379**	13,950
Other receivables and current assets	**68,660**	56,910
Total	**1,155,939**	1,605,125

(in thousands roubles)

15. Cash and Cash Equivalents

As of December 31 cash and cash equivalents comprised the following:

	2005	**2004, as restated**
Cash at bank and on hand	**632,281**	463,098
Letters of credit	**139,801**	–
Total	**772,082**	463,098

Letters of credit totaling 139,801 are irrevocable and valid from December 29, 2005 till January 31, 2006.

Cash in foreign currency comprised 468 as of December 31, 2005 (2004 - 455) denominated in USA dollars.

16. Significant Non-Cash Transactions

In 2005 the Company received telecommunication equipment under lease agreements in the amount of 976,490 (2004 – 1,399,382).

In 2005 revenue from services settled by exchange of services amounted to 1,839,768 (2004 – 1,589,261).

The Company has not received property, plant and equipment under vendor financing terms in 2005 (2004 – 1,876,115).

The Company received equipment contributions in 2005 in the amount of 25,303 (2004 – 44,622).

Non-cash transactions above have been excluded from the consolidated statement of cash flows.

17. Share Capital

Total number of outstanding shares is as follows:

	Number of shares outstanding (thousands)	**Par value**	**Carrying value**
As at December 31, 2003	**3,932,665**	**1,297,779**	**3,039,255**
Preference	972,152	320,810	751,302
Ordinary	2,960,513	976,969	2,287,953
As at December 31, 2004	**3,932,665**	**1,297,779**	**3,039,255**
Preference	972,152	320,810	751,302
Ordinary	2,960,513	976,969	2,287,953
As at December 31, 2005	**3,932,665**	**1,297,779**	**3,039,255**

17. Share Capital (continued)

All shares have a par value of 0.33 Roubles. The difference between the total par value and the total carrying value of share capital represents the effects of inflation accumulated through January 1, 2003.

The ordinary shareholders are entitled to one vote per share.

Preference shares give the holders the right to participate in general shareholders' meetings without voting rights except in instances where decisions are made in relation to re-organization and liquidation of the Company, and in relation to changes and amendments to the Company's charter which restrict the rights of preference shareholders. Preference shares have no rights of redemption or conversion but carry non-cumulative dividends per share of 10% of the Russian accounting net income ot Southern Telecommunications Company for the year. If Southern Telecommunications Company fails to pay the above mentioned dividends, or has no profits in any year, owners of preference shares have the right to vote in the general shareholders' meeting. Owners of preference shares have the right to participate in and vote on all issues within the competence of general meetings following the annual general meeting at which a decision not to pay (or to pay partially) dividends on preferred shares has been taken. The annual amount of dividends on preference shares may not be less than of the dividends on ordinary shares. The owners of preference shares participate in earnings along with ordinary shareholders. Accordingly, the Company's preferred shares are considered participating equity instruments for the purpose of earnings per share calculations (refer to Note 28).

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

Distributable earnings of the parent company are limited to its retained earnings, as mandated by the statutory accounting rules. Statutory retained earnings of the parent company as of December 31, 2005 and 2004 amounted to 5,299,498 and 5,276,023 respectively.

In accordance with the Russian legislation, dividends may only be declared to the shareholders of the Company from net income as shown in the Company's Russian statutory financial statement. Southern Telecommunications Company reported the net income of 305,203 and 241,299 in its statutory financial statements in 2005 and 2004, respectively.

Dividends were declared in 2005 in respect of 2004 to holders of ordinary shares and preference shares of 0.00934 Rouble per ordinary share (2004 – 0.0812 Rouble per ordinary share) and 0.02847 Rouble per preference share (2004 – 0.1111 Rouble per preference share). See also Note 29.

In February 1998 the Company registered Level 1 American Depositary Receipts (ADR). Each ADR represents 50 shares of common stock of the Company.

(in thousands roubles)

17. Share Capital (continued)

The following table represents ADR registration for 2003-2005:

	ADR (quantity)	Ordinary Shares Equivalent (quantity)	Ordinary Shares %	Charter Capital %
December 31, 2003	2,228,802	111,440,100	3.76%	2.83%
Decrease 2004	(647,422)	(32,371,100)	(1.09%)	(0.82%)
December 31, 2004	1,581,380	79,069,000	2.67%	2.01%
Additions 2005	1,245,299	62,264,950	2.10%	1.58%
December 31, 2005	**2,826,679**	**141,333,950**	**4.77%**	**3.59%**

Currently ADR are traded on the following stock markets:

Stock market	CUSIP(WKN)	ADR ticker	ISIN
Over-the-counter (OTC) market (USA)	843899105	STJSY	S1843899105
Frankfurt Stock Exchange (FSE)	912640	KUE.FRA	US8438991056
Berlin Stock Exchange (BerSE)	912640	KUE	US8438991056
NEWEX (Vienna, Austria)	912640	KUE	US8438991056

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

	Ordinary shares		Preference shares		
	Number (thousands)	%	Number (thousands)	%	Total
OJSC "Svyazinvest"	1,500,671	50.69%	–	–	1,500,671
Other legal entities	1,162,328	39.26%	736,271	75,74%	1,898,599
Individuals	297,514	10.05%	235,881	24.26%	533,395
Total	**2,960,513**	**100%**	**972,152**	**100%**	**3,932,665**

(in thousands roubles)

18. Borrowings

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

	Interest rate	2005	2004, as restated
Short-term borrowings			
Bank loans:			
Bank loans (Roubles)	11.6% - 14%	**645,998**	751,298
Total bank loans		**645,998**	751,298
Vendor financing:			
Vendor financing (US Dollars)	6.7%-8%	**–**	14,058
Total vendor financing		**–**	14,058
Promissory notes (Roubles)	10.75% - 17%	**925,138**	1,976,771
Interest payable		**656,025**	677,493
Total short–term borrowings		**2,227,161**	3,419,620
Long–term borrowings			
Bank loans:			
Bank loans (Roubles)	11.6% - 15%	**5,836,172**	8,550,489
Total bank loans		**5,836,172**	8,550,489
Bonds (Roubles)	10% - 14.24%	**11,356,778**	6,440,351
Vendor financing:			
Vendor financing (Euro)	5.9% - 8.5%	**950,541**	1,170,352
Vendor financing (US Dollars)	6.7%	**–**	50,971
Vendor financing (Japanese Yen)	7.56%	**–**	20,689
Total vendor financing		**950,541**	1,242,012
Promissory notes:			
Promissory notes (US Dollars)	5.9%	**218,602**	605,474
Promissory notes (Roubles)	12.2% - 12.7%	**183,860**	–
Total promissory notes		**402,462**	605,474
Other loans (RUR)	14% - 21%	**50,356**	52,062
Less: Current portion of long–term borrowings		**(10,141,593)**	(5,382,728)
Total long–term borrowings		**8,454,716**	11,507,660

As of December 31, 2005 bank loans are secured by property, plant and equipment with the carrying value of approximately 9,014,939 (2004 – 12,280,636) (see Note 5).

(in thousands roubles)

18. Borrowings (continued)

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

Maturity date	Bank loans	Bonds	Vendor financing	Promissory notes	Other	Total
2006	2,811,949	7,186,250	1,117,944	1,246,467	6,144	12,368,754
2007	1,958,997	1,297,412	10,206	180,000	1,672	3,448,287
2008	1,513,889	750,000	–	–	1,613	2,265,502
2009	25,000	2,500,000	–	–	2,012	2,527,012
2010 and after	175,000	–	–	–	38,915	213,915
Total	**6,484,835**	**11,733,662**	**1,128,150**	**1,426,467**	**50,356**	**20,823,470**

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

Currency	2005	2004, as restated
Russian Roubles	**19,476,718**	18,158,828
Euro	**1,128,150**	1,459,987
US dollars	**218,602**	670,504
Japanese yen	–	20,689
Total	**20,823,470**	20,310,008

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

Short-Term Borrowings

Bank Loans

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

Alfa-Bank

Short-term borrowings from Alfa-Bank represent Rouble denominated loans received in 2005. The loans bear interest of 11.9-14%. As of December 31, 2005, the outstanding amount of short term loans was 560,000. The loans are secured with property, plant and equipment valued at 751,683.

18. Borrowings (continued)

Long-Term Loans and Borrowings

Bank Loans

Sberbank

Long-term borrowings from Sberbank represent Rouble denominated loans received in 2003-2005. The loans mature in 2008-2010. The loans bear interest of 13-15%. As of December 31, 2005, the outstanding amount of long-term borrowings from Sberbank was 2,563,000. The loans are secured with property, plant and equipment valued at 2,957,334.

Alfa-Bank

Long-term borrowings from Alfa-Bank represent Rouble denominated loans received in 2004-2005. The loans mature in 2006. The loans bear interest of 12%. As of December 31, 2005, the outstanding amount of long-term borrowings from Alfa-Bank was 607,085. The loans are secured with property, plant and equipment valued at 1,286,475.

Vneshtorgbank

Long-term borrowings from Vneshtorgbank represent Rouble denominated loans received in 2004-2005. The loans mature in 2006-2007. The loans bear interest of 12%. As of December 31, 2005, the outstanding amount of long-term borrowings from Vneshtorgbank was 363,000. Loans are secured with property, plant and equipment valued at 418,445.

Bank of Moscow

Long-term borrowings from Bank of Moscow represent Rouble denominated loans received in 2005. The loans mature in 2008. The loans bear interest of 12.5%. As of December 31, 2005, the outstanding amount of long-term borrowings from Bank of Moscow was 1,752,886. Loans are secured with property, plant and equipment valued at 2,131,287.

Promstroybank

Long-term borrowings from Promstroybank represent Rouble denominated loans received in 2004. The loans mature in 2007. The loans bear interest of 13.1%. As of December 31, 2005, the outstanding amount of long-term borrowings from Promstroybank was 550,000. Loans are secured with property, plant and equipment valued at 1,277,328.

18. Borrowings (continued)

Long-Term Loans and Borrowings (continued)

Bonds

On September 18, 2003 the Company issued 1,500 thousand non-convertible interest-bearing bonds, Series 01, par value of 1,000 Rubles each. The bonds mature in three years from the date of issue (September 2006) and provides semiannual coupons. The coupon interest rate is 14.24% per annum.

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 from the date of issue (February 2007) and provides semiannual coupons. The interest rate of the first and second coupons is 9.25% p.a. The interest rate of the third and fourth coupons is 12%. The bond issue has two options of earlier redemption at par value - in February 2005 and February 2006. Accordingly, these bonds have been included into current portion of long-term liabilities at December 31, 2005 and 2004. In February 2005 bondholders exercised the right of early redemption in the amount of 1,092,657 and these bonds were placed at the secondary market at par for the same amount. In February 2006 bondholders exercised the right of early redemption in the amount of 217,596 (see Note 34).

On October 6, 2004 the Company issued 3,500 thousand non-convertible interest-bearing bonds, Series 03, par value of 1,000 Rubles each. The bonds mature in five years from the date of issue (October 2009) and provides semiannual coupons. The coupon interest rate for the first three coupons was determined at 12.3% p.a. The other coupon rates are determined ten days before the coupon payment days. The bond issue has two options of early redemption at par value - in April, 2006 and October, 2007. Accordingly, the amount of bonds with the possibility of early redemption option in April, 2006 has been included in current portion of long-term liabilities at December 31, 2005 and long-term liabilities as of December 31, 2004. In April 2006 the bondholders did not exercise the right of early redemption (see Note 34).

On December, 2005 the Company issued 5,000 thousand non-convertible interest-bearing bonds Series 04, par value of 1,000 Rubles each. The bonds mature in four years from the date of issue (December 2009) and provide quarterly coupons. The coupon interest rate for the first four coupons was determined at 10.5% p.a. These bonds do not provide early redemption options. The amount of bonds to be repaid on December 14, 2006 in accordance with the payment schedule in amount of 500,000 has been included in current portion of long-term liabilities at December 31, 2005.

(in thousands roubles)

18. Borrowings (continued)

Long-Term Loans and Borrowings (continued)

Vendor Financing

Vnesheconombank

In 1995-1996, the Ministry of Finance of the Russian Federation provided long-term financing to the Company to purchase telecommunications equipment from various foreign vendors. Vnesheconombank acted as the agent on behalf of the Government of Russian Federation. The loan is denominated in EURO. The loan is received under agreements with the Ministry of Finance of the Russian Federation and bears floating interest rate Plafond C plus 2% that approximated 6.5% per annum in 2005. The loan is unsecured. As of December 31, 2005 the outstanding principal amount comprised 637,608. This amount includes 591,352 of overdue amount at December 31, 2005. The interest payable is 174,421 at December 31, 2005. The penalty interest related to overdue principal amount is 270,343 at December 31, 2005. The Company included the total amount outstanding to OJSC Vnesheconombank into the short-term portion of long term borrowings (See Note 34).

As described in Note 30 “Contingencies and operating risks” in July 2005 the Company received a claim from the Ministry of Finance of the Russian Federation for immediate repayment of outstanding amount overdue to the bank.

Promissory Notes

In December 2004 the Company issued non interest bearing promissory notes transferred to LLC “IBM Eastern Europe/Asia” at discounted amount of 619,420 (face value 648,810). As of June 1, 2006 the Company fully repaid the promissory notes issued (see Note 34).

The Company issued non interest bearing promissory notes transferred to OJSC “Vneshtorgbank” totaling 1,038,964 with discount 12.5-14%. The promissory notes mature in 2006-2007.

In 2005 the Company restructured certain payables to suppliers for services and issued promissory notes at par for the amount of 1,204,632 (see Note 2). The promissory notes mature in 2006.

19. Finance Lease Obligations

The Company purchases telecommunication equipment underfinance lease contracts. Future minimum lease payments under finance lease contracts together with the present value of the net minimum lease as of December 31 are as follows:

	2005		**2004, as restated**	
	Minimum lease payments	**Present value of payments**	**Minimum lease payments**	**Present value of payments**
Current portion	1,559,700	1,013,513	1,506,229	988,925
1 to 5 years	2,713,564	2,071,503	2,943,620	2,210,188
Total minimum lease payments	4,273,264	3,085,016	4,449,849	3,199,113
Less amounts representing finance charges	(1,188,248)	–	(1,250,736)	–
Present value of minimum lease payments	**3,085,016**	**3,085,016**	**3,199,113**	**3,199,113**

(in thousands roubles)

19. Finance Lease Obligations (continued)

In 2005 and 2004, the Company's primary lessor was OJSC "RTC-Leasing". In 2005, the effective interest rate on lease liabilities ranged from 20% to 25% per annum (2004 - 17% to 24% per annum).

The Company's obligations under finance leases to OJSC "RTC-Leasing" as of December 31, 2005 comprised 4,258,736 (2004 – 4,354,613), including 3,073,859 principal amount (2004 – 3,113,955) and 1,184,877 interest payable (2004 – 1,240,658).

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

As of December 31, 2005 finance lease obligations denominated in US Dollars and Euro comprised nill and 7,169, respectively (2004 – 27,062 and 68,098, respectively).

20. Accounts Payable, Accrued Expenses and Advances Received

Accounts payable and other current liabilities comprised the following as of December 31:

	2005	**2004, as restated**
Accounts payable to equipment suppliers and constructors	**1,396,781**	2,355,250
Salaries and wages	**743,979**	415,473
Trade accounts payables	**373,087**	562,932
Advances received from subscribers	**361,175**	351,668
Universal service fund contribution	**136,980**	–
Other accounts payable	**72,509**	48,165
Total	**3,084,511**	3,733,489

Accounts payable to equipment suppliers and constructors in the amount of 1,135 and 1,090 included in trade payables as of December 31, 2005 and 2004, respectively, are denominated mainly in US Dollars.

21. Other Taxes Payable

Taxes payable comprised the following as of December 31:

	2005	**2004, as restated**
Value added tax	**272,254**	200,114
Property tax	**172,533**	158,137
Unified social tax	**64,648**	119,250
Personal income tax	**35,309**	27,189
Other taxes	**30,301**	10,699
Total	**575,046**	515,389

(in thousands roubles)

21. Other Taxes Payable (continued)

The amount of value added tax payable includes value added tax in the amount of 162,341 (2004 – 130,005) which represents deferred value added tax that is only payable to the tax authorities when the underlying receivables are recovered or written off.

As of January 1, 2006 a number of amendments to the Tax Code relating to the rules of determination of the taxable base became effective (see Note 34).

22. Pensions Liabilities

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

The defined benefit pension plan provides old age retirement pension and disability pension. The plans provides 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 specific to each branch of the Company. According to the formula the benefits depend on a number of parameters, including the relative pay of participants and their length of service in the Company at retirement. The benefits do not vest until and are subject to the employee retiring from the Company on or after the above-mentioned ages, except for employees redundant less than two year before achievement the statutory conditions guarantee pension payments.

Non-government pension fund Telecom-Soyuz, which is related to the Company (Note 32), maintains the defined benefit pension plan. The Company makes contributions to the pension fund in the amount set forth in the agreement with the pension fund.

The Company further provides other long-term employee benefits such as a death-in-service payments and lump-sum payments upon retirement of a defined benefit nature.

Additionally the Company provides financial support of a defined benefit nature to its old age and disabled pensioners.

As of December 31, 2005 there were 37,867 employes, all of them are participants of the defined benefit pension plan and long-term social programe of the Company (2004 – 40,432).

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

	2005	**2004, as restated**
Present value of defined benefit obligation	**1,982,837**	1,597,334
Fair value of plan assets	**(47,469)**	(204,573)
Present value of unfunded obligations	**1,935,368**	1,392,761
Unrecognized past service cost	**(402,107)**	(259,305)
Unrecognized actuarial (losses)/gains	**(665,209)**	(403,885)
Net pension liability in the balance sheet	**(868,052)**	(729,571)

(in thousands roubles)

22. Pensions Liabilities (continued)

As of December 31, 2005 management estimated employees’ average remaining working life at 9 years (2004 - 10 years).

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

	2005	**2004, as restated**
Interest cost	**146,573**	106,021
Service cost	**94,301**	66,860
Amortization of past service cost– non-guaranteed portion	**46,777**	58,943
Expected return on plan assets	**(24,107)**	(15,568)
Actuarial (gains)/losses	**24,415**	–
Net expense for the defined benefit pension plan	**287,959**	216,256

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

	2005	**2004, as restated**
Net liability at January 1	**729,571**	597,681
Net expense for the year	**287,959**	216,256
Contributions	**(149,478)**	(84,366)
Net liability at December 31	**868,052**	729,571

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

	2005 Per annum	**2004 Per annum**
Discount rate	**7%**	9.18%
Expected return on plan assets	**9.69%**	9.33%
Future salary increases	**8.15%**	9.18%
Relative pay increase (career progression)	**1%**	1%
Rate used for calculation of annuity value	**6%**	6%
Increase in financial support benefits	**5%**	6%
Staff turnover	**7%**	7%
Mortality tables (source of information)	**USSR 985/86**	Russia 1998

Movements in the net assets of defined benefit pension plan and other post-employment benefits were as follows:

	2005	**2004, as restated**
Fair value of plan assets at January 1	**204,573**	146,347
Employer contributions	**149,478**	84,366
Retern on plan assets	**5,911**	14,856
Benefits paid	**(312,493)**	(40,996)
Fair value of plan assets at December 31	**47,469**	204,573

(in thousands roubles)

22. Pensions Liabilities (continued)

During 2005 the Company changed the provisions of the defined benefit pension plan thus extending its liabilities under pension agreements.

Actual return on plan assets for 2005 was 4.37%.

As of December 31, 2005 assets of defined benefit pension plan included bonds and promissory notes of the Company which made 0.11% and 3.63% of the total plan assets respectively (as of December 31, 2004 - promissory notes which made 6.1%)

23. Revenues

Revenues for the year ended December 31 comprised the following:

By revenue types	2005	2004, as restated
Local telephone calls	**6,499,392**	4,786,789
Long distance telephone services – domestic	**5,799,265**	6,187,938
New services	**1,399,613**	803,421
Long distance telephone services – international	**1,154,243**	1,164,852
Rent of telephone channels	**810,369**	624,930
Installation and connection fees	**665,100**	1,326,811
Services to local operators	**665,718**	610,866
Construction services	**467,407**	193,463
Other telecommunications services	**446,969**	394,872
Radio and TV broadcasting	**204,113**	192,045
Recreational services	**196,390**	106,382
Data transfer and telemetric services	**156,416**	170,750
Revenue from rent of assets	**108,944**	93,635
Documentary services	**53,013**	70,515
Agency fees	**30,298**	21,613
Sale of goods	**23,267**	124,461
Cellular services	**6,592**	209,224
Sale of cable production	–	185,359
Other revenues	**86,838**	62,889
Total	**18,773,947**	17,330,815

In 2004 the Company included the revenues from domestic and international connections received from the other operators into the revenues from national telephone operators. In 2005 the Company included these revenues in the domestic and international long distance telephone services and made reclassifications to the comparative 2004 information in the amount of 293,913 and 69,079 correspondingly.

(in thousands roubles)

23. Revenues (continued)

The Company identifies revenue by the following major customer groups:

Customer groups	2005	2004, as restated
Residential customers	**10,606,107**	10,043,576
Corporate customers	**6,711,172**	5,982,811
Government customers	**1,456,668**	1,304,428
Total	**18,773,947**	17,330,815

24. Other Operating Expenses

Other operating expenses comprised the following:

	2005	2004, as restated
Fire and other security services	**253,243**	246,840
Lease of premises	**186,541**	131,106
Universal service fund contribution	**137,237**	–
Audit and consulting fees	**134,538**	77,055
Cost of goods sold	**92,186**	152,981
Insurance	**90,006**	223,907
Charitable contributions	**89,262**	83,158
Agency fees	**63,841**	43,115
Charges for undue payments	**61,025**	62,599
Advertising expenses	**59,450**	69,927
Transportation services	**53,122**	54,463
Business travel expenses and representation costs	**48,290**	64,731
Charges due settlements with non-payers	**43,638**	35,451
Education expenses	**32,267**	38,926
Civil defense	**31,666**	28,715
Non-commercial partnership expenses (Note 32)	**27,930**	–
Payments to professional unions, cultural events expenses	**24,704**	23,653
Payments to Gossvyaznadzor	**–**	49,094
Other expenses	**563,539**	175,023
Total	**1,992,485**	1,560,774

In 2005 the Company incurred an expense on contribution to Universal service fund. These payments are mandated by the Federal Law on Communications and Government Decree # 243 of April 21, 2005. Contribution is calculated as 1.2% of the revenues from the telecommunication services decreased by revenues from interconnection services. Related contingency is disclosed in Note 30.

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

(in thousands roubles)

25. Interest Expense, net

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

	2005	2004, as restated
Interest income	**(13,126)**	(11,709)
Interest expense on loans	**1,445,039**	1,219,878
Interest expence on bonds	**769,472**	353,076
Interest expense on finance leases	**647,412**	511,506
Interest expense on vendor financing	**17,532**	8,193
Total	**2,866,329**	2,080,944

26. Gain/(Loss) on Sale of Subsidiaries, Associates and Other Investments

Gain/(Loss) from sale of subsidiaries, associates and other investments for the years ended December 31 comprised the following:

	2005	2004, as restated
Loss on sale of CJSC "CMTO"	**(6,063)**	–
Gain on sale of OJSC "Telesot-Alaniya"	–	52,904
Gain on sale of OJSC "Stavropolskoe commercheskoe televidenie"	**39**	–
Gain on sale of CJSC "Volgograd-Mobile"	–	82,157
Gain on sale of CJSC "Astrakhan-Mobile"	–	29,562
Gain on sale of CJSC "Cellular communications - Alaniya"	–	8,530
Other gain (loss) on investments	**(1)**	13,139
Dividend income	**1,968**	2,106
Total	**(4,057)**	188,398

27. Income Tax

Income tax charge for the years ended December 31 comprised the following:

	2005	2004, as restated
Current income tax expense	**(9,193)**	(273,357)
Deferred income tax (expense)/benefit	**(205,167)**	181,597
Total income tax expense	**(214,360)**	(91,760)

(in thousands roubles)

27. Income Tax (continued)

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

	2005	2004, as restated
Loss before income tax	(842,839)	(200,459)
Statutory income tax rate	**24%**	24%
Theoretical tax charge at statutory income tax rate	**202,280**	48,110
(Increase)/decrease resulting from the effect of:		
Non-taxable income	170,484	85,883
Non-deductible expenses	(398,706)	(265,172)
Pensions	(143,921)	–
Other	(44,499)	39,417
Total income tax charge for the year at the effective rate	**(214,360)**	(91,760)
Effective tax rate	**25.43%**	45.78%

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

	As at December 31, 2003, as restated	Origination and reversal of temporary differences	Acquisition of susbidiaries	Sale of subsidiaries	As at December 31, 2004, as restated	Origination and reversal of temporary differences	Sale of subsidiaries	As at December 31, 2005
Deferred tax assets								
Deferred revenues	99,979	14,100	–	–	**114,079**	(193)	–	**113,886**
Accounts payable and accrued liabilities	29,208	8,394	–	–	**37,602**	(27,339)	–	**10,263**
Accounts receivable	75,500	14,132	–	–	**89,632**	(45,978)	(119)	**43,535**
Other	4,050	(2,487)			**1,563**	(1,563)		
Total deferred tax assets	208,737	34,139	–	–	**242,876**	(75,073)	(119)	**167,684**
Deferred tax liabilities								
Fixed Assets	(1,018,666)	257,391	–	2,091	**(759,184)**	38,407	8,274	**(712,503)**
Intangible assets	(7,848)	(8,186)	(12,721)	–	**(28,755)**	(18,916)	–	**(47,671)**
Effect from investments valuation	(30,375)	(16,199)	–	–	**(46,574)**	(2,947)	–	**(49,521)**
Finance Lease Obligations	(71,300)	(51,233)	–	–	**(122,533)**	(90,604)	–	**(213,137)**
Other	(46,607)	(34,315)	–	–	**(80,922)**	(56,034)	–	**(136,956)**
Total deferred tax liabilities	(1,174,796)	147,458	(12,721)	2,091	**(1,037,968)**	(130,094)	8,274	**(1,159,788)**
Deferred Tax Liabilities, net	(966,059)	181,597	(12,721)	2,091	**(795,092)**	(205,167)	8,155	**(992,104)**

(in thousands roubles)

27. Income Tax (continued)

In the context of the effective tax legislation, tax losses and current tax assets of the different companies may not be set off against current tax liabilities and taxable profits of other companies and, accordingly, taxes may accrue even where there is a net consolidated tax loss. Therefore, deferred tax asset of one subsidiary of the Company is not offset against deferred tax liability of another subsidiary.

Accordingly, the mentioned above differences were presented as follows in the balance sheet as of December 31:

	2005	**2004, as restated**
Deferred Tax Asset	**167,684**	242,876
Deferred Tax Liability	**(1,159,788)**	(1,037,968)
Deferred tax liability, net	**(992,104)**	(795,092)

The movement in deferred tax asset for the years ended December 31 comprised:

	2005	**2004, as restated**
Deferred tax asset, at January 1	**242,876**	208,737
Deferred tax income (expense)	**(75,073)**	34,139
Deferred tax assets of acquired subsidiaries	**(119)**	–
Deferred tax asset, at December 31	**167,684**	242,876

The movement in deferred tax liability for the years ended December 31 comprised:

	2005	**2004, as restated**
Deferred tax liability, at January 1	**(1,037,968)**	(1,174,796)
Deferred tax expense	**(130,094)**	147,458
Deferred tax liabilities of acquired subsidiaries	**–**	(12,721)
Deferred tax liabilities of subsidiaries disposed	**8,274**	2,091
Deferred tax liability at December 31	**(1,159,788)**	(1,037,968)

28. Loss per Share

Loss per share is calculated by dividing the net loss attributable to equity holders of the Parent by the weighted average number of shares in issue during the period.

The calculation of basic and diluted loss attributable to ordinary shares outstanding is presented below (loss per share data is stated in Roubles):

	2005	**2004, as restated**
Loss attributable to equity holders of the Parent	**(1,053,292)**	(331,515)
Weighted average number of shares outstanding (thousands) (see Note 17)	**3,932,665**	3,932,665
Basic and diluted loss attributable to equity holders of the Parent, Russian Roubles	**(0.27)**	(0.08)

(in thousands roubles)

28. Loss per Share (continued)

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

29. Dividends Declared for Distribution

Dividends declared in 2005 based on the 2004 results:

Dividends on ordinary shares – 0.00934 Roubles per share	27,651
Dividends on preference shares – 0.02847 Roubles per share	27,677
Total	**55,328**

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

30. Contingencies and Operating Risks

Operating Environment of the Company

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

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.

Legal System

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 position or future results of operations. In the nearest future the Company’s activity could be subject to judicial reform factors. The financial statements do not include any adjustment that may result from these uncertainties.

30. Contingencies and Operating Risks (continued)

Taxation

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

Claims of Tax Authorities

During 2005 a tax examination of the Company’s operations for the years 2002-2003 was executed by the tax authorities. As a result, the Company received a claim totaling 1,053,846, including fines and penalties of 375,866.

Currently, management is not able to determine reliably the amount of this exposure, if any. At the date of approval of these financial statements the probability of Court examination can not be determined reliably in view of absence of existing court practice regarding above tax issues. No amounts related to this issue were accrued by the Company as of December 31, 2005.

Insurance Coverage

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

Legal Proceeding

In July 2005 the Ministry of Finance of the Russian Federation filed a claim against the Company demanding immediate repayment of debts outstanding to Vnesheconombank as of June 30, 2005 in the amount of 973,609 (28,201 thousand euro). As of December 31, 2005 the outstanding principal amount comprised 637,608. This amount includes 591,352 of overdue amount at December 31, 2005. The interest payable is 174,421, the penalty interest relating to overdue principal amount is 270,343 at December 31, 2005 (see Note 18).

In addition, during the year the Company was involved in a number of court proceedings (both as a plaintiff and a defendant) arising in the ordinary course of business. In the opinion of management, except as described above, there are no current legal proceedings of other claims outstanding, which could have a material effect on the result of operations or financial position of the Company and which have not been accrued or disclosed in these consolidated financial statements.

30. Contingencies and Operating Risks (continued)

Licenses

Largely all of the Company's revenues are derived from operations conducted pursuant to licenses granted by the Russian Government. These licenses expire in various years ranging from 2006 to 2012. The suspension or termination of the Company's main licenses or any failure to renew any or all of these main licenses could have a material adverse effect on the financial position and operations of the Company.

The Company renewed these licenses on a regular basis in the past, and believes that it will be able to renew licenses without additional cost in the normal course of business.

The Government of the Russian Federation is in the process of liberalizing the telecommunications market for which additional licenses on providing DLD/ILD have been granted to a number of alternative operators. The Company's future results of operations and cash flows may be materially affected by the increased competition in a particular period but the effect can not be currently determined.

Decree No. 87 of the Government of the Russian Federation of February 18, 2005 "Concerning the Endorsement of the Itemization of the Communication Services Entered in Licenses and the Lists of License Terms" (amended by Decree No. 837 of December 29, 2005) prescribed the types of connection services that are to be included in licenses and the list of licensing terms. In November 2005, the Company submitted to the Federal Service for Communications Supervision (Rossvyaznadzor) its request for changes and amendments to the existing Licenses for the provision of telecommunications services in order to bring the License terms in compliance with the requirements set by Governmental Decree No. 87. All the necessary amendments to the licenses were received except for the license for the provision of local telecommunications services using payphones and mutual access devices. The Company is in the process of obtaining the required amendments to this license.

Guarantees Issued

The Company guarntees issued primarily relate to credit line facilities provided by Sberbank and Rosbank to OJSC "RTC-Leasing", a lessor of telecommunication equipment, as of December 31, 2005 (Note 19). The total guarantees amounted to 2,159,032 and 165,672, respectively (2004 – 3,185,693 and 377,150).

Universal Service Fund Contribution

Industry regulations effective as of December 31, 2005 did not provide a clear guidance with respect to the calculation of the contribution amount. Accordingly, there is a risk of incorrect determination of the contribution payable to this fund.

(in thousands roubles)

31. Contractual Commitments

Operating Leases

As of December 31 the future minimum lease payments under non-cancellable operating leases are presented in the aggregate and for each of the following periods:

	2005	**2004, as restated**
Current portion	**38,835**	83,275
From 1 to 5 years	**32,743**	48,127
Over 5 years	**69,872**	60,964
Total	**141,450**	192,366

Finance Leasing

In 2005 the Company did not enter into any new finance leases (see also Note 11).

Capital Investments

As of December 31, 2005 the Company has commitments for capital investments into modernization and expansion of its network in the amount of 33,461 (2004 – 311,605).

Acquisition of Intangible Assets

As of December 31, 2005 the Company has commitments for the purchase of intangible assets approximately in amount of 297,056 (2004 – 204,672). These commitments relate primarily to implementation of Amdocs Billing Suite.

32. Balances and transactions with related parties

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

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

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

(in thousands roubles)

32. Balances and Transactions with Related Parties (continued)

Rendering Services

The Company rendered services to the following related parties during the year ended December 31:

Related party	Relationship	Type of sales	2005	2004, as restated
OJSC "Rostelecom"	Controlled by Svyazinvest	Telecommunication services	**649,246**	636,126
CJSC "Volgograd-GSM"	Associate company	Telecommunication services	**76,838**	122,888
CJSC "TeleRossKubanElektrosvyaz"	Associate company	Telecommunication services	**8,016**	4,918
LLC "Yug-Giprosvyaz"	Associate company	Telecommunication services	**7,125**	12,040
OJSC "Central Telegraph"	Controlled by Svyazinvest	Telecommunication services	**3,592**	2,268
CJSC "Stavropolskaya sotovaya sviz"	Associate company	Telecommunication services	**1,089**	1,037
OJSC "Telecompaniya IR"	Associate company	Telecommunication services	**399**	390
CJSC "ZanElCom"	Associate company	Telecommunication services	**317**	593
CJSC "TeleRossVolgograd"	Associate company	Telecommunication services	**37**	379
OJSC "Severo-Zapadniy Telecom"	Controlled by Svyazinvest	Telecommunication services	**13**	9
OJSC "VolgaTelecom"	Controlled by Svyazinvest	Telecommunication services	**12**	9
OJSC "Center Telecommunication Company"	Controlled by Svyazinvest	Telecommunication services	**3**	24
OJSC "Sibirtelecom"	Controlled by Svyazinvest	Telecommunication services	**–**	71
CJSC "Karachaevo-CherkesskTeleSot"	Associate company	Telecommunication services	**–**	9,328

Purchases

During the year ended December 31 the following related parties rendered services to the Company:

Related party	Relationship	Type of sales	2005	2004, as restated
OJSC "Rostelecom"	Controlled by Svyazinvest	Telecommunication services	**2,045,692**	2,042,723
LLC "Yug-Giprosvyaz"	Associate company	Design and estimate services	**167,177**	521,098
Non-commercial partnership "Center for Research of Problems in Development of Telecommunications"	Controlled by Svyazinvest	Contributions, membership fees, Agent agreement	**29,656**	33,010
CJSC "Volgograd-GSM"	Associate company	Cellular services, GSM-900MHz	**5,912**	6,065
OJSC "Central Telegraph"	Controlled by Svyazinvest	Telecommunication services	**2,319**	754
OJSC "Informatsionnye Tehnologii Svyazy" (OJSC "Svyazintech")	Controlled by Svyazinvest	IT consulting and software dising	**1,595**	–
CJSC "Stavropolskaya sotovaya sviz"	Associate company	Cellular services, AMPS-800MHz	**5**	34,542
CJSC "Karachaevo-CherkesskTeleSot"	Associate company	Cellular services, GSM-900MHz	**–**	592
OJSC "Severo-Zapadniy Telecom"	Controlled by Svyazinvest	Telecommunication services	**–**	36

The sales and purchases from related parties are made at normal market prices.

(in thousands roubles)

32. Balances and Transactions with Related Parties (continued)

Accounts Receivable

Significant balances of accounts receivable from related parties were as follows as of December 31:

Related party	Relationship	Type of sales	2005	2004, as restated
Non-commercial partnership “Center for Research of Problems in Development of Nelecommunications”	Controlled by Svyazinvest	Agent agreement	**113,520**	95,175
LLC “Yug-Giprosvyaz”	Associate company	Telecommunication services	**28,950**	15,838
CJSC “Volgograd-GSM”	Associate company	Telecommunication services	**5,220**	
OJSC “Central Telegraph”	Controlled by Svyazinvest	Telecommunication services	**399**	317
CJSC “Stavropolskaya sotovaya sviz”	Associate company	Telecommunication services	**342**	149
CJSC “ZanElCom”	Associate company	Telecommunication services	**42**	19
CJSC “TeleRossKubanElektrosvyaz”	Associate company	Telecommunication services	**14**	31
OJSC “Telecompaniya IR”	Associate company	Telecommunication services	**2**	10
CJSC “Karachaevo-CherkesskTeleSot”	Associate company	Telecommunication services	**–**	322
CJSC “Kabardino-Balkarskiy GSM”	Associate company	Telecommunication services	**–**	57

Accounts Payable:

Significant balances of accounts payable to related parties were as follows as of December 31:

Related party	Relationship	Type of sales	2005	2004, as restated
LLC “Yug-Giprosvyaz”	Associate company	Design and estimate services	**175,526**	137,010
OJSC “Rostelecom”	Controlled by Svyazinvest	Telecommunication services	**134,918**	106,953
Non-commercial partnership “Center for Research of Problems in Development of Nelecommunications”	Controlled by Svyazinvest	Contributions	**27,930**	8,873
CJSC “Volgograd-GSM”	Associate company	Cellular services, GSM-900MHz	**812**	946
OJSC “Informatsionnye Tehnologii Svyazy” (OJSC “Svyazintech”)	Controlled by Svyazinvest	IT consulting and software dising	**638**	–
OJSC “Central Telegraph”	Controlled by Svyazinvest	Telecommunication services	**461**	57
OJSC “Telecompaniya IR”	Associate company	Telecommunication services	**186**	–
CJSC “TeleRossKubanElektrosvyaz”	Associate company	Telecommunication services	**56**	–
CJSC “ZanElCom”	Associate company	Nettwork information technologies operation and maintenance	**17**	4
OJSC “VolgaTelecom”	Controlled by Svyazinvest	Telecommunication services	**14**	–
CJSC “TeleRossVolgograd”	Associate company	Telecommunication services	**3**	2
CJSC “Stavropolskaya sotovaya sviz”	Associate company	Cellular services, AMPS-800MHz	**1**	3
OJSC “Severo-Zapadniy Telecom”	Controlled by Svyazinvest	Telecommunication services	**1**	3
CJSC “Karachaevo-CherkesskTeleSot”	Associate company	Cellular services, GSM-900MHz	**–**	264

32. Balances and Transactions with Related Parties (continued)

Outstanding balances at the year-end are unsecured, interest free and settlements occur in cash. There have been no guaranties provided or received for any related party receivables or payables. For the year ended December 31, 2005, the Company has not made any provision for doubtful debts relating to amounts owned by related parties (2004 – nil). This assessment is undertaken each financial year through examining the financial position of the related party and the market in which the related party operates.

OJSC Svyazinvest

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

The Government has and may be expected to continue to exercise significant influence over the operations of Svyazinvest and its subsidiary companies.

The Government’s influence is not confined to its share holdings in 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.

In 2005 dividends were paid to Svyazinvest in the amount of 14,016. In 2005 the Company accrued dividends to Svyazinvest in the amount of 14,016 (2004 - 121,854).

OJSC Rostelecom

Rostelecom, a majority owned subsidiary of 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 Rostelecom and terminated outside of the Company’s network is stated as interconnection charges. Further, Rostelecom uses the Company’s network to provide incoming long-distance and international traffic to its subscribers and partner operators. Changes in settlements with OJSC “Rostelecom” effective January 1, 2006 are described in Note 34.

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. The Company also renders services to other state-owned entities. Certain entities financed by the Government budget are users of the Company’s network. These entities are generally charged lower tariffs as approved by the Federal Antimonopoly Agency than those charged to other customers. In addition, the Government may by law require the Company to provide certain services to the Government in connection with national security and the detection of crime.

32. Balances and Transactions with Related Parties (continued)

Transactions with Government Organizations (continued)

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

As of December 31, 2005 government subscribers and receivables from state budget on reimbursement for services to privileged customers accounted for approximately 44% (2004 – 50%) of gross trade accounts receivable and are equal to 649,037 (2004 – 761,920) (Note 13). Revenues from government subscribers are presented in Note 23.

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

Non-commercial partnership "Centre for Research of the Problems in Development of Telecommunications" (hereinafter "the Partnership") is an entity controlled by Svyazinvest via its subsidiaries. The Company is a member of the Partnership and has an agreement with it under which it provides funding for industry research and common administrative activities on behalf of the Company and other subsidiaries and associates of Svyazinvest. Payments to the Partnership are included into other operating expenses in the accompanying consolidated statement of operations for the year ended December 31, 2005 in the amount of 27,930 (2004 – nil).

NPF Telecom-Soyuz

In 2004 the Company had a number of pension agreements with NPF Telecom-Soyuz (hereinafter "the Fund"). In 2005 the Company has signed one centralized pension agreement which replaced the previous ones (see Note 22). Svyazinvest holds the majority in the Board of Directors of the Fund. In 2005 the payments from the Company to the Fund amounted to 149,478 (2004 – 84,366).

Compensation to Key Management Personnel

Key management personnel comprise members of the Management Board and the Board of Directors of the Company, totaling 23 and 32 persons as of December 31, 2005 and 2004, respectively. Total compensation to key management personnel is included into the line "Wages, salaries, other employee benefits and payroll taxes" in the statement of operations and amounted to 44,816 and 67,192 for the years ended December 31, 2005 and 2004, respectively.

Compensation to key management personnel consists of contractual salary, performance bonus depending on operating results and payments for non-government pension benefits.

(in thousands roubles)

33. Financial Instruments and Risk Management Objectives and Policies

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

Foreign Exchange Risk

Foreign exchange risk is the risk that fluctuations in exchange rates will adversely affect items in the Company's statement of operations, balance sheet and/or cash flows. Foreign currency denominated liabilities (see Notes 18, 19 and 20) give rise to foreign exchange exposure. Insignificant amount of foreing currency denominated assets (see Note 15) do not give rise to foreign exchange exposure.

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

As at December 31, 2005 the Company's liabilities in foreign currency were 1,356,126 (2004 – 2,247,430), including liabilities denominated in US dollars 220,807 (2004 – 698,656) and Euro and other currencies 1,135,319 (2004 – 1,548,774).

For the period from January 1, 2004 to December 31, 2005 exchange rate of the Russian Rouble to US Dollar decreased by approximately 2.3% and exchange rate of the Russian Rouble to Euro decreased by approximately 7.9%. Possible decrease in the exchange rate of the Russian Rouble may lead to an increase in the amount of the Company's borrowings, as well as will cause difficulties in attraction of funds including funds required for refinancing of the existing debt.

Interest Rate Risk

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

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

As of December 31, 2005:	**< 1 year**	**1–5 years**	**> 5 years**	**Total**
Fixed rate				
Short-term obligations	**2,227,161**	–	–	**2,227,161**
Long-term obligations	**2,317,736**	**8,240,801**	**213,915**	**10,772,452**
Finance lease obligations	**1,013,513**	**2,071,503**	–	**3,085,016**
Floating rate				
Long-term obligations	**7,823,857**	–	–	**7,823,857**

As of December 31, 2004:	**< 1 year**	**1–5 years**	**> 5 years**	**Total**
Fixed rate				
Short-term obligations	3,419,620	–	–	3,419,620
Long-term obligations	3,073,642	8,021,635	38,489	11,133,766
Finance lease obligations	988,925	2,210,188	–	3,199,113
Floating rate				
Long-term obligations	2,309,086	3,447,536	–	5,756,622

33. Financial Instruments and Risk Management Objectives and Policies (continued)

Interest Rate Risk (continued)

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

The Company has no significant interest-bearing assets other than those presented above.

Credit Risk

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

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

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

Fair Value

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

(in thousands roubles)

33. Financial Instruments and Risk Management Objectives and Policies (continued)

Fair Value (continued)

Set out below is the comparison by category of carrying amounts and fair values of all of the Company’s financial instruments:

	2005		2004	
Financial instruments	**Carrying amount**	**Fair value**	**Carrying amount**	**Fair value**
Financial Assets				
Investments in associates	**578,761**	**578,761**	526,876	526,876
Long-term investments available for sale	**45,421**	**45,421**	27,678	27,678
Long-term accounts receivable	**479,743**	**479,743**	545,529	545,529
Long-term borrowings given	**15,321**	**15,321**	20,826	20,826
Accounts receivable	**755,722**	**755,722**	1,055,475	1,055,475
Other current assets	**1,155,939**	**1,155,939**	1,168,539	1,168,539
Cash and cash equivalents	**772,082**	**772,082**	463,098	463,098
Total	**3,802,989**	**3,802,989**	3,808,021	3,808,021
Financial Liabilities				
Long-term bank loans	**3,672,886**	**3,672,886**	6,245,642	6,245,642
Long-term bonds	**4,547,412**	**4,548,050**	4,947,536	5,232,497
Long-term promissory notes	**180,000**	**180,000**	219,294	219,294
Long-term suppliers' credits	**10,206**	**10,206**	48,093	48,093
Other long-term obligations	**44,212**	**44,212**	47,095	47,095
Long-term finance lease obligations	**2,071,503**	**2,071,503**	2,210,188	2,210,188
Accounts payable	**3,084,511**	**3,084,511**	3,733,489	3,733,489
Short-term bank loans	**648,663**	**648,663**	751,298	751,298
Short-term promissory notes	**1,024,005**	**1,024,005**	1,976,771	1,976,771
Short-term suppliers' credits	–	–	14,058	14,058
Current portion of long-term bank loans	**2,163,286**	**2,163,286**	2,304,847	2,304,847
Current portion of long-term bonds	**7,186,250**	**7,272,784**	1,492,815	1,598,337
Current portion of long-term promissory notes	**222,462**	**222,462**	386,181	386,181
Current portion of long-term suppliers' credits	**1,117,944**	**1,117,944**	956,491	956,491
Current portion of other long-term obligations	**6,144**	**6,144**	4,967	4,967
Current portion of long-term finance lease obligations	**1,013,513**	**1,013,513**	988,925	988,925
Total	**26,992,997**	**27,080,169**	**26,327,690**	**26,718,173**

34. Subsequent Events

New Provisions of the Federal Law on Communications

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

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

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

Changes in Settlements with OJSC “Rostelecom” in 2006

Prior to January 1, 2006 the Company, in accordance with the terms of its license for telecommunication services, rendered domestic long-distance (DLD) and international long-distance (ILD) services (“long-distance services”) to its customers. Revenues and receivables from rendering of the services were recognized as the Company’s revenues and receivables. In accordance with the new Russian telecommunications legislation, the Company will switch to the new system of interaction with Russian operators and subscribers (“end users”) for the provision of domestic long-distance (DLD) and international long-distance (ILD) services (“long-distance services”) with effect from January 1, 2006.

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

34. Subsequent Events (continued)

Changes in Settlements with OJSC “Rostelecom” in 2006 (continued)

In accordance with the new regulations that came into effect on January 1, 2006, the principles governing the interaction of operators in the provision of long-distance services to end users changed as follows:

- operators of DLD and ILD telephone networks (“long-distance operators”) will provide long-distance services to subscribers of local network operators;
- operators of intra-regional telephone networks will provide long-distance operators with intra-regional origination and termination of calls; and
- local telephone network operators will provide intra-regional network operators with local origination and termination of calls.

Settlements between operators will be conducted in the order of the services rendered. Subscriber billing and collection activities, as well as other customer services, will be performed by the Company as an agent.

Contracted services will include customer services to end users, invoicing, and collection of payments for long-distance services provided by the Company. While relying on resources and data supplied by the Company in calculating charges for long-distance services, OJSC “Rostelecom” will bear responsibility for calculating charges in accordance with applicable regulations.

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

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

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

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

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

34. Subsequent Events (continued)

Changes in Settlements with Interconnected Operators

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

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

Starting from January 1, 2006 settlements are bylateral and consist of the following:

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

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

In April, 2006 the Company signed agreements of interconnection and traffic transmission with OJSC “Rostelecom” and OJSC “Multiregional Transit-Telecom”. In July, 2006 the Company signed agreements with LLC “Sovintel” as long distance domestic and international telephone services operator.

Currently the Company is undertaking the necessary renegotiations with a number of interconnected operators. The Company expects to finalize these negotiations in 2006.

Interconnection services are currently included into services regulated by the Government. As a consequence the interconnection fee is to be prescribed by the regulating body. Ceiling tariffs on connection services and transfer of traffic for the Company are established by Rossvyaznadzor under order # 51 dated June 19, 2006 “On establishment of ceiling prices on connection services and transfer of traffic”.

Significant Operator

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

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

34. Subsequent Events (continued)

Significant Operator (continued)

An operator occupying an important position in the general-use communications network on the territories of several subjects of the Russian Federation establishs the terms for connecting telecommunications networks and for letting through traffic separately on the territory of each subject of the Russian Federation. An operator occupying an important position in the general-use communications network is obliged to conclude a contract for connecting the other telecommunication operators to its network.

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

Rendering of Universal Telecommunication Service

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

In March, 2006 the Company participated in a tender for provision of universal communications service in the Southern Federal District. The Company won the tender for provision of telecommunication service in Rostov region and was appointed by the Government of the Russian Federation to provide telecommunication services in Astrakhan region.

Cancellation of Charges for Incoming Calls

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

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

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

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

34. Subsequent Events (continued)

Tariffs for Telecommunication Services

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

In November 2005 the Company submitted its proposed tariffs to Rossvyaznadzor for approval. The tariffs were determined based on the 2005 rates. Noted ceiling tariffs were approved by Rossvyaznadzor under order # 51 dated June 19, 2006 "On establishment of ceiling prices on connection services and transfer of traffic" and become effective from July 1, 2007.

In December 2005 the Federal Service for Communications Supervision determined the amount of the compensation surcharge to be included in rates for call origination services provided by the Company as a significant operator. The surcharge is set at 0.64 Roubles per minute and is effective starting January 1, 2006. The compensation surcharge is supposed to cover the difference between an operator's income and economically justified costs in providing local and intra-regional communication services.

Changes in settlements with OJSC "Rostelecom" in 2006 and with interconnected operators as well as rendering of Universal telecommunication service will require from the Company additional capital investments.

Investments Comply with New Industry Regulations

In order to comply with the requirements of new industry regulations the management of the Company intends to invest approximately 323,000 in 2006 and 670,000 in 2007-2008 for network development and purchase of telecommunication equipment .

Impact of New Rules for Rendering of Telecommunication Services on Financial Statements

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

Value Added Tax

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

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

(in thousands roubles)

34. Subsequent Events (continued)

Dividends

On June 27, 2006 the general meeting of the Company’s shareholders approved dividends for 2005 in the amount of:

Dividends declared for 2005

Dividends on ordinary shares – 0.01031 Roubles per share	30,523
Dividends on preference shares – 0.031395 Roubles per share	30,521
Total	**61,044**

Employee Redundancy Program

In accordance with the Employee Redundancy Plan the Company dismissed 856 employees paying compensations totaling 12,803 between December 31, 2005 and the date of the authorisation of these financial statements for the issue.

Bonds

From February 9, 2006 till February 15, 2006, bondholders of Series 02 bonds exercised the right of early redemption in the amount of 217,596 and these bonds were placed at the secondary market at par for the amount of 217,596.

On April 14, 2006, bondholders of Series 03 bonds did not exercise the right of early redemption.

Loans and Borrowings

Vneshtorgbank

In March 2006, the Company signed the contract with Vneshtorgbank on the short-term loan in the amount of 150,000 with 10.25% annual interest rate. Maturity date is September 8, 2006.

In April 2006, the Company signed two contracts with Vneshtorgbank on the short-term loans in amounting to 400,000 with 9.75% annual interest rate. The loans mature on 23 and 25 of September 2006.

In May 2006, the Company signed the contract with Vneshtorgbank on the short-term loan in the amount of 130,000 with 9.75% annual interest rate. Maturity date is August 19, 2006.

Joint-stock Bank “International Moscow Bank”

In May 2006, the Company signed the contract with Joint-stock Bank “International Moscow Bank” on the long-term loan in the amount of 300,000 with 10,8% annual interest rate. Maturity date is November 26, 2007.

34. Subsequent Events (continued)

Loans and Borrowings (continued)

Credit Suisse

On June 23, 2006 the Board of Directors approved loan agreements with Credit Suisse in total amount ing to 175,000 thousands US dollars, including:

- 50,000 thousands US dollars with annual interest rate equals to margin of 5.6% annual interest rate and LIBOR rate, the loan mature in 2008 - 2009. The loan is secured with property, plant and equipment valued at 1,673,403;
- 125,000 thousands US dollars with annual interest rate equals to margin of 4.4% annual interest rate and LIBOR rate, the loan mature in 2010-2013. The loan is secured with property, plant and equipment valued at 125,375 thousands US dollars.

Bank of Moscow

In February 2006, the Company signed the contract for open the credit line facility with Bank of Moscow in the amount of 200,000 with 7.5% annual interest rate. According to the terms of agreement this loan must be repaid during one month. The contract is valid until February 21, 2007.

General Director ____________ *Andreev A. V.* *Chief Accountant* __________*Rusinova T. V.*