MOSCOW CITY TELEPHONE NETWORK AND SUBSIDIARIES

Independent Auditors' Report

Consolidated Financial Statements
Years Ended December 31, 2005 and 2004 (Restated)

MOSCOW CITY TELEPHONE NETWORK AND SUBSIDIARIES

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INDEPENDENT AUDITORS' REPORT

To the shareholders of OJSC Moscow City Telephone Network:

We have audited the accompanying consolidated balance sheets of OJSC Moscow City Telephone Network ("MGTS") and its subsidiaries (collectively – the "Group") as of December 31, 2005 and 2004, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Group as of December 31, 2005 and 2004, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 25 to the consolidated financial statements, the accompanying consolidated financial statements for the year ended December 31, 2004 have been restated.

April 7, 2006

MOSCOW CITY TELEPHONE NETWORK AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2005 AND 2004 (restated)
(in U.S. dollars and in thousands, except for share amounts)

		2005		2004
ASSETS				**As restated, see Note 25**
CURRENT ASSETS:				
Cash and cash equivalents (Note 5)		27,483		28,748
Short-term investments (Note 6)		61,675		25,609
Accounts receivable, advances and taxes receivable, net (Note 7)		97,792		75,323
Inventories and spare parts		14,501		15,550
Deferred income taxes, net (Note 16)		9,562		11,432
Assets held for resale (Note 3)		15,260		-
Total current assets	$	226,273	$	156,662
NON-CURRENT ASSETS:				
Property, plant and equipment, net (Note 8)		1,038,141		976,966
Advance payments for property, plant and equipment		8,985		7,248
Intangible assets, net (Note 9)		27,058		19,494
Long-term investments (Note 10)		7,497		171,332
Restricted cash (Note 11)		2,272		972
Total non-current assets		1,083,953		1,176,012
TOTAL ASSETS	$	**1,310,226**	$	**1,332,674**
LIABILITIES AND SHAREHOLDERS' EQUITY				
CURRENT LIABILITIES:				
Short-term debt (Note 11)		83,123		72,278
Accounts payable, taxes payable and accrued liabilities (Note 12)		56,456		39,733
Deferred revenue, current portion (Note 13)		47,964		46,605
Total current liabilities	$	187,543	$	158,616
NON-CURRENT LIABILITIES:				
Long-term debt (Note 11)		110,631		117,282
Deferred revenue (Note 13)		109,958		97,538
Retirement and post-retirement benefits (Note 14)		16,217		11,513
Property, plant and equipment contributions (Note 15)		102,746		103,822
Deferred income taxes, net (Note 16)		17,323		22,099
Total non-current liabilities		356,875		352,254
TOTAL LIABILITIES	$	**544,418**	$	**510,870**
COMMITMENTS AND CONTINGENCIES (Note 23)		-		-
SHAREHOLDERS' EQUITY:				
Preferred stock, 15,965,850 shares authorized, issued and outstanding (Note 17)		22,538		22,538
Common stock, 79,829,200 shares authorized, issued and outstanding (Note 17)		112,462		112,462
Shares of Comstar UTS (Note 10)		(173,441)		-
Additional paid-in capital		61,806		61,806
Retained earnings		715,095		565,572
Accumulated other comprehensive income (Note 3)		27,348		59,426
Total shareholders' equity		765,808		821,804
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$	**1,310,226**	$	**1,332,674**

See notes to consolidated financial statements.

MOSCOW CITY TELEPHONE NETWORK AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, 2005 and 2004
(in U.S. dollars and in thousands, except for per share amounts)

	2005	2004
Operating revenues (Note 18)	$ 639,624	$ 480,847
Operating expenses, net (Note 19)	(445,430)	(381,337)
OPERATING INCOME	194,194	99,510
Interest income	3,773	3,430
Interest expense	(15,035)	(17,133)
Currency transaction gain/(loss)	841	(470)
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAX EXPENSE	183,773	85,337
Income tax expense (Note 16)	(43,262)	(26,622)
Income from affiliates	21,023	16,133
INCOME FROM CONTINUING OPERATIONS	161,534	74,848
Gain from discontinued operations (Note 5), net of income tax effect of $729	-	2,133
Loss on disposal of discontinued operations (Note 5), net of income tax effect of $429	-	(1,954)
NET INCOME	$ **161,534**	$ **75,027**
Earnings per common share before gain from discontinued operations, basic and diluted	$ 1.69	$ 0.78
Gain from discontinued operations	-	0.00
Earnings per common share, basic and diluted (Note 20)	$ **1.69**	$ **0.78**
Weighted average number of common shares outstanding	79,829,200	79,829,200

See notes to consolidated financial statements.

MOSCOW CITY TELEPHONE NETWORK AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004
(in U.S. dollars and in thousands)

	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 161,534	$ 75,027
Adjustments to reconcile net income to cash provided by operating activities:		
Loss from discontinued operations	-	(179)
Allowance for doubtful accounts	3,326	(500)
Depreciation charge	74,496	68,011
Currency transaction (gain)/loss	(841)	470
Income from affiliates	(21,023)	(16,133)
Deferred gain amortization	-	(735)
Deferred taxes	(2,477)	3,070
Post-retirement benefits	5,014	6,315
Loss on disposal of property, plant and equipment	4,903	4,166
Gain on disposal of long-term investments	(1,954)	-
Changes in operating assets and liabilities:		
Accounts receivable, advances and taxes receivable	(28,500)	(19,321)
Inventories	490	(865)
Accounts payable, taxes payable and accrued liabilities	16,851	10,826
Deferred revenue	20,357	26,665
Net cash provided by operating activities	232,176	156,817
CASH FLOWS FROM INVESTING ACTIVITIES:		
Dividends received from investees	1,007	474
Purchases of property, plant and equipment	(157,591)	(122,219)
Purchases of intangible assets	(13,090)	(10,101)
Proceeds from sale of property, plant and equipment	1,351	1,323
Proceeds from sale of long-term investments	1,972	652
Purchases of short-term investments, net	(34,466)	(13,622)
Net cash used in investing activities	(200,817)	(143,493)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from borrowings	89,153	89,059
Repayments of borrowings	(82,064)	(76,122)
Repayments of vendor financing	(16,616)	(12,780)
Payments on capital leases	(10,506)	(9,278)
Dividends paid	(11,559)	(9,228)
Net cash used in financing activities	(31,592)	(18,349)
EFFECTS OF CURRENCY TRANSLATION ON CASH AND CASH EQUIVALENTS	(1,032)	2,007
DECREASE IN CASH AND CASH EQUIVALENTS	(1,265)	(3,018)
CASH AND CASH EQUIVALENTS, beginning of year	28,748	31,766
CASH AND CASH EQUIVALENTS, end of year	$ 27,483	$ 28,748

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004 (continued)
(in U.S. dollars and in thousands)

		2005		2004
SUPPLEMENTAL INFORMATION:				
Cash paid for interest, net of amounts capitalized	$	14,232	$	13,649
Income taxes paid	$	45,779	$	25,478
NON-CASH INVESTING AND FINANCING ACTIVITIES:				
Property, plant and equipment received free of charge	$	6,281	$	13,597
Equipment acquired through vendor financing (Note 11)	$	2,921	$	20,714
Equipment acquired under capital leases (Note 11)	$	25,817	$	25,765

In addition, non-cash investing activities during the year ended December 31, 2005 included disposals of shares of subsidiaries and affiliates, as described in Note 10.

See notes to consolidated financial statements.

MOSCOW CITY TELEPHONE NETWORK AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004 (restated)
(in U.S. dollars and in thousands, except for share and per share amounts)

	Preferred stock		Common stock		Treasury stock	Additional paid-in capital	Retained earnings	Accumula-ted other compre-hensive income	Total
	Shares	**Amount**	**Shares**	**Amount**					
Balances at January 1, 2004 (As restated, see Note 25)	**15,965,850**	**$ 22,538**	**79,829,200**	**$ 112,462**	**$ -**	**$ 61,806**	**$ 500,4**	**$ 11,71**	**$ 708,92**
Net income	-	-	-	-	-	-	75,02	-	75,0
Dividends declared on preferred shares	-	-	-	-	-	-	(6,57	-	(6,57
Dividends declared on common shares	-	-	-	-	-	-	(3,28	-	(3,28
Translation adjustment (Note 3)	-	-	-	-	-	-	-	47,71	47,7
Balances at December 31, 2004	**15,965,850**	**$ 22,538**	**79,829,200**	**$ 112,462**	**$ -**	**$ 61,806**	**$ 565,57**	**$ 59,42**	**$ 821,80**
Net income	-	-	-	-	-	-	161,53	-	161,53
Dividends declared on preferred shares	-	-	-	-	-	-	(6,77	-	(6,776)
Dividends declared on common shares	-	-	-	-	-	-	(5,23	-	(5,235)
Translation adjustment (Note 3)	-	-	-	-	-	-	-	(32,07	(32,078)
Restructuring of Comstar UTS (Note 10)	-	-	-	-	(173,441)	-	-	-	(173,441)
Balances at December 31, 2005	**15,965,850**	**$ 22,538**	**79,829,200**	**$ 112,462**	**$ (173,441)**	**$ 61,806**	**$ 715,0**	**$ 27,3**	**$ 765,80**

Dividends declared for 2004 were $0.42 and $0.07 per preferred and common share, respectively.
Dividends declared for 2003 were $0.41 and $0.04 per preferred and common share, respectively.

See notes to consolidated financial statements.

(in U.S. dollars and in thousands unless otherwise stated)

1. THE GROUP

Description of Business - Moscow City Telephone Network ("MGTS") operates one of the largest metropolitan communication networks in the world. Founded in 1882 and nationalized in 1917, MGTS was privatized and became an open joint stock company in 1994. MGTS provides telecommunication services to residential subscribers, state-financed institutions and businesses within the city of Moscow.

The principal activities of the Group's subsidiaries as of December 31, 2005 are as follows:

Operating Entities	Short Name	Principal activity
AMT	AMT	Radiotelephony services and repair of telecommunication equipment.
Petrodvor	Petrodvor	Providing services to the entities of the Group.
United TeleSystems MGTS	UTS MGTS	Holding the Group's shares in JSC Comstar - United Telesystems

In November 2005, JSFC Sistema ("Sistema"), the Group's ultimate controlling shareholder, contributed its shareholdings in MGTS to the share capital of Comstar - United Telesystems ("Comstar UTS"), its subsidiary providing the fixed line communication services, including voice, Internet dial-up and ADSL, and various value added services, to commercial and residential customers throughout the Moscow metropolitan area (see also Note 10 for additional information on restructuring of Comstar UTS). Effective November 2005, the Group's immediate parent is Comstar UTS.

Local telephone services are regulated tariff services and changes in rate structure are subject to approval of Federal Tariff's Service ("FTS"). In 2005 and 2004, approximately 63% and 61%, respectively, of the Group's revenues were generated from regulated tariff services. Fixed monthly fees approved by FTS during 2005 are presented in the table below:

In Rubles:	January 1 - September 30, 2005	October 1 - December 31, 2005
Residential customers (including VAT)	170	200
State-financed institutions	170	200
Corporate entities	200	210

Residential customers are charged a fixed monthly fee while corporate entities and state-financed institutions are charged for local traffic in addition to a fixed monthly fee.

2. INVESTMENT PROGRAM

In December 2003, the Group announced its long-term investment program for the period from 2004 to 2012 providing for extensive capital expenditures including expansion and full digitalization of the Moscow telephone network. The program was approved by the resolution of Moscow City Government of December 16, 2003. At the inception of the investment program, capital expenditures were estimated to be approximately $1.6 billion and included reconstruction of 350 local telephone stations and installation of 4.3 million of new phone numbers.

In the course of completion of the investment program, MGTS entered into a series of agreements with Sistema Hals, a subsidiary of Sistema, on project development and reconstruction of buildings of automatic telephone exchanges. The main part of work under the contracts is to be performed in 2006-2008.

As of December 31, 2005, the Group has commitments to spend $6.1 million on network development and acquisition of new telecommunication equipment.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND RECENT ACCOUNTING PRONOUNCEMENTS

Basis of Presentation - The accompanying financial statements have been prepared in conformity with the accounting principles generally accepted in the United States of America ("U.S. GAAP"). The Group's entities maintain accounting records in Russian Rubles ("RUR") in accordance with the requirements of Russian accounting legislation. The accompanying financial statements differ from the financial statements prepared for statutory purposes in the Russian Federation (the "RF") in that they reflect certain adjustments, appropriate to present the financial position, results of operations and cash flows in accordance with U.S. GAAP, which are not recorded in the statutory accounting books of the Group's entities.

Principles of Consolidation - The consolidated financial statements for the years ended December 31, 2005 and 2004 include the accounts of MGTS and its wholly-owned subsidiaries – AMT, Petrodvor and UTS MGTS. All significant intercompany transactions, balances and unrealized gains (losses) have been eliminated.

Use of Estimates - The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses for the period. Actual results could differ from these estimates.

Examples of significant estimates include the allowance for doubtful accounts, the recoverability of long-lived assets and valuation allowances on deferred taxes.

Concentration of Business Risk - The Group's business activities are within the RF. Laws and regulations affecting businesses operating in the RF are subject to rapid changes, which could impact the Group's assets and operations.

Foreign Currency Translation - The Group follows a translation policy in accordance with the provisions of Statement of Financial Accounting Standard ("SFAS") No. 52, "Foreign Currency Translation".

Management has determined that the Group's functional currency is the Russian ruble. The Group selected the U.S. dollar ("USD") as its reporting currency and translates functional currency financial statements of its entities into USD. Assets and liabilities are translated at the exchange rates current at the balance sheet date, while income and expense items are translated at the average exchange rate for the quarter in which such transactions occurred. The resulting translation adjustment is recorded as a separate component of other comprehensive income.

The official rate of exchange, as determined by the Central Bank of the RF, between the Ruble and the U.S. Dollar at December 31, 2005 was 28.78 Rubles to 1 U.S. dollar (2004: 27.75).

The Ruble is not a fully convertible currency outside of the territory of the RF. The translation of RUR-denominated assets and liabilities into USD for the purpose of these financial statements does not indicate that the Group could or will in the future convert the reported values of the assets and liabilities in USD.

Revenue Recognition - The Group's revenues are principally derived from the provision of local telephone and data transmission services which consist of (i) usage charges, (ii) monthly telephone service fees, (iii) service activation and installation fees, (iv) revenues from use of prepaid phone cards and (v) charges for value-added telecommunication services. The Group records revenues over the periods they are earned as follows:

(i) Revenues derived from local telephone usage and data transmission are recognized as the services are provided;
(ii) Monthly telephone service fees are recognized in the month during which the telephone services are provided to customers;
(iii) Upfront fees received for activation and installation of wireline and data transmission services are deferred and recognized over the expected customer relationship period. According to management estimates, the customer relationship period for wireline voice phone subscribers is 15 years for residential customers and 5 years for all other categories of subscribers;
(iv) Revenues from sale of prepaid calling cards are recognized as cards are used by customers or the prepaid cards expire;
(v) Revenues derived from value-added telecommunication services are recognized when the services are provided to customers.

Other related telecommunications service revenues are recognized as follows:

(i) Revenues from the provision of internet-services are recognized when the services are provided to customers;
(ii) Interconnection fees from other telecommunications operators are recognized when the services are provided to the operators;
(iii) Lease income from operating leases is recognized over the term of the lease.

Management believes that the Group is not subject to the requirements of FAS 71, "Accounting for the Effects of Certain Types of Regulation" as the regulated rates for certain types of services are not designed to recover the specific Group's costs of providing the regulated services or products.

Cash and Cash Equivalents - Cash and cash equivalents include cash on hand, amounts on deposit in banks and cash invested temporarily in various highly liquid instruments with maturities of three months or less at time of purchase.

Fair Value of Financial Instruments - Financial instruments carried on the balance sheet include cash and bank balances, receivables, investments, accounts payable and long-term debt. The particular recognition methods adopted are disclosed in the individual policy statements associated with each item.

Fair values of corporate bonds issued by MGTS are disclosed in Note 11.

Accounts Receivable - Accounts receivable are stated at their net realizable value after deducting an allowance for doubtful accounts. Such allowance reflects either specific cases of delinquency or defaults or estimates based on evidence of collectibility.

Concentrations of credit risk with respect to trade receivables are limited due to a highly diversified customer base, which includes a large number of individuals, private businesses and state-financed institutions.

Inventories and Spare Parts - Inventories and spare parts comprise cables, spare parts, telephones and accessories and are stated at the lower of cost or market. Cost is computed on an average cost basis.

Assets Held for Sale – Assets held for sale comprise the cost of a building constructed on behalf of the Group with intention to sale to a third party.

Property, Plant and Equipment - Property, plant and equipment is stated at cost less accumulated depreciation, except for assets contributed by Sistema under the investment program and assets received free of charge from third parties. These assets have been initially recorded at fair values based on the estimated market values at the time of the transfer.

Significant renovations are capitalized if they extend the life of the asset or significantly increase its revenue generating capacity. Repairs and maintenance are charged to the statement of operations as incurred.

The Group accounts for leases based on the requirements of SFAS No. 13, "Accounting for Leases." Leases are classified as capital leases whenever the terms of the lease transfer substantially all of the benefits and rewards incident to the ownership. All other leases are classified as operating leases. Capital leases are recorded at the fair market value of the asset or the present value of future minimum lease payments, whichever is lower. The discount rate used in determining present value of the minimum lease payments is the Group's incremental borrowing rate, unless (1) it is practicable to learn the implicit rate computed by the lessor and (2) the implicit rate is less than the Group's incremental borrowing rate. If both of those conditions are met, the interest rate implicit in the lease is used.

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

Property, plant and equipment is depreciated on a straight-line basis over the following estimated useful lives:

	Years
Buildings	47
Analogue telecommunication equipment	17
Digital telecommunication equipment	10
Transmission devices	31
Site improvements	44
Other equipment	3 – 25

Property, plant and equipment held and used by the Group is reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of assets may have been impaired. Management is not aware of any indicators of impairment occurred relating to the Group's investments in property, plant and equipment during the years ended December 31, 2004 and 2003.

The Group incurs costs associated with operating and other equipment, which require installation and related works to enable assets to commence revenue generating activities. All costs necessarily incurred which are directly attributable to the construction, preparation and installation of an item to commence revenue-generating activities are capitalized.

Property, plant and equipment which were transferred to the Group free of charge is capitalized at its market value at the date of transfer and deferred revenue is recorded and amortized to the consolidated statement of operations over the contributed assets' life.

Intangible Assets – Intangible assets comprise mostly billing systems and other software and are stated at acquisition cost. Amortization is computed on a straight-line basis of five years.

Asset Retirement Obligations - In accordance with FAS No. 143, "Accounting for Asset Retirement Obligations", the Group calculates an asset retirement obligation and an associated asset retirement cost when the Group has a legal obligation in connection with the retirement of tangible long-lived assets. The Group's obligations under FAS No. 143 arise from certain of its leases and relate primarily to the cost of removing equipment from such lease sites. As of December 31, 2005 the estimated assets retirement obligations were not significant to the Group's consolidated financial position and results of operations.

Investments - Investments in businesses in which the Group does not have control, but exercises significant influence over operating and financial policies ("affiliates"), are accounted for using the equity method. The Group's share of net assets and net income of affiliates is included in the consolidated net assets and operating results using the equity method of accounting.

Prior to December 2005, MGTS owned 51% of voting common shares of Mediatel, with the remaining shares owned by Concern SITRONICS, a subsidiary of Sistema. Mediatel, a company incorporated in the RF, is providing support and maintenance services related to telecommunication equipment and software, primarily to the Group and Comstar UTS. In January 2004, MGTS has entered into an agreement with Concern SITRONICS in respect of corporate governance of Mediatel that provided that control over operating and financial policies of Mediatel (including, but not limited to, the rights to establish its operating and capital decisions, including budgets, and the rights to select and set the compensation of management responsible for implementation of these decisions) was transfered to Concern SITRONICS. In 2005 and 2004, the Group's investment in Mediatel was accounted for using the equity method of accounting. In December 2005, MGTS sold 51% stake in Mediatel to Concern SITRONICS for cash consideration of $1.9 mln.

Prior to November 2005, MGTS owned 51% of voting common shares of MTU-Inform, while Sistema and its subsidiary owned 48% of MTU-Inform. In May 2004, Sistema announced completion of the operational merger of its three digital operators: MTU-Inform, Comstar and Telmos. The legal merger was completed in 2005 (see Note 10 for additional information). In May 2004, MGTS and Sistema agreed to transfer the operating and financial control over operations of MTU-Inform to Comstar UTS. In July 2004, MTU-Inform entered into agreement with Comstar UTS for the transfer to Comstar UTS of management functions over MTU-Inform's operations. As a result of the contractual arrangement, the Group ceased to have the controlling financial interest over MTU-Inform's operations. Following the transfer of the control over MTU-Inform, the Group's share in the earnings of MTU-Inform for the years ended December 31, 2005 and 2004 was recorded using the equity method of accounting.

Investments in corporate shares where the Group owns more than 20% of share capital, but does not have the ability or intent to control or exercise significant influence over operating and financial policies, as well as investments in corporate shares where the Group owns less than 20% of share capital, are accounted for at cost of acquisition. Management periodically assesses realizability of the carrying values of such investments and provides valuation reserves, if required.

The promissory notes purchased by the Group are carried at cost and a discount against the nominal value is accrued over the period to maturity, if it exceeds one year. A provision is made, based on management assessment, for notes that are considered uncollectible.

Retirement and Post-Retirement Benefits - Contributions are made to the governmental social and medical insurance and retirement benefit schemes at the statutory rates in force during the year.

In Russia, all social contributions, including contributions to the pension fund, are substituted with a unified social tax ("UST") calculated by the application of a regressive rate from 26% to 2% (from

35.6% to 2% before January 1, 2005) of the annual gross remuneration of each employee. UST is allocated to three social funds, including the pension fund, where the rate of contributions to the pension fund vary from 20% to 2% (from 28% to 2% before January 1, 2005), respectively, depending on the annual gross salary of each employee. The contributions are expensed as incurred.

The Group has historically offered its employees certain benefits upon and after retirement. The cost of such benefits is recognized during an employee's years of active service (Note 14). The Group accounts for pension plans following the requirements of FAS No. 87, "Employers' Accounting for Pensions" and FAS No. 132R, "Employers' Disclosure about Pensions and Other Postretirement Benefits, an amendment of FASB Statements No. 87, 88 and 106". The Group's contributions to the plan assets are managed by the Pension Fund Sistema, a subsidiary of Sistema.

Income Taxes - Income taxes have been computed in accordance with RF laws. Income tax rate in RF is 24%. In July 2004, amendments to Russian income tax legislation were enacted to increase, effective January 1, 2005, the income tax rate on dividends paid within Russia to 9% (previously 6%).

Deferred income taxes are accounted for under the liability method and reflect the tax effect of all significant temporary differences between the tax basis of assets and liabilities and their reported amounts in the consolidated financial statements. A valuation allowance is provided for deferred tax assets if it is more likely than not that these items will either expire before the Group will be able to realize the benefit, or the future deductibility is uncertain.

Borrowing Costs - The Group capitalizes interest on borrowings during the active construction period of major capital projects. Capitalized interest is added to the cost of the underlying assets and is amortized over the useful lives of the assets. For the years ended December 31, 2005 and 2004 capitalized borrowing costs amounted to $0.5 mln. and $0.8 mln., respectively. Other borrowing costs were recognized as an expense in the period in which they were incurred. Debt issue costs are amortized to expense over the term to maturity.

Earnings Per Share - Earnings per share is computed using the two-class method. Net income available to common shareholders is divided by the weighted average number of common shares outstanding during the year. Net income available to common shareholders is determined by reducing net income by the income attributable to the holders of preferred shares (Note 20).

Comprehensive Income - Comprehensive income is defined as net income plus all other changes in net assets from non-owner sources. The following is a reconciliation of net and comprehensive income, net of income tax effect:

	2005	**2004**
Net income	161,5[illegible]	75,0[illegible]
Other comprehensive income: translation adjustment	(32,07	47,7[illegible]
Total comprehensive income	**129,4[illegible]**	**122,7[illegible]**

Reclassifications - Certain reclassifications of prior years' amounts have been made to conform to the presentation adopted for 2005.

New Accounting Pronouncements - In December 2004, the FASB issued FAS No. 153, "Exchanges of Nonmonetary Assets", an amendment of APB Opinion No. 29, "Accounting for Nonmonetary Transactions". FAS No. 153 eliminates the exception from fair value measurement for nonmonetary exchanges of similar productive assets set in the APB Opinion No. 29 and replaces it with a general exception for exchanges that do not have commercial substance. FAS No. 153 specifies that a nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. FAS No. 153 is effective prospectively for nonmonetary exchanges occurring after June 15, 2005. The adoption of FAS No. 153 did not have a material impact on the Group's financial position or results of operations.

In December 2004, the Financial Accounting Standards Board ("FASB") issued FAS No. 123R, "Share-Based Payment" ("FAS No. 123R"), a revision of FAS No. 123, "Accounting for Stock-Based Compensation". FAS No. 123R supersedes Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees" and requires all entities to recognize compensation cost in an amount equal to the fair value of share-based payments grant-date to employees. That cost is recognized over the period during which an employee is required to provide service in exchange for an award of equity instruments. FAS No. 123R must be adopted by most public entities no later than the beginning of the first fiscal year commencing after June 15, 2005. The adoption of FAS No. 123R did not have a material impact on the Group's financial position or results of operations.

In March 2005, FASB issued Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations - an interpretation of FASB Statement No. 143." This Interpretation clarifies that the term "conditional asset retirement obligation" as used in FASB Statement No. 143, "Accounting for Asset Retirement Obligations", refers to a legal obligation to perform an asset retirement activity, in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. Uncertainty about the timing and (or) method of settlement of a conditional asset retirement obligation should be factored into the measurement of the liability when sufficient information exists to make a reasonable estimate of the fair value of the obligation. Interpretation 47 is effective for the Group beginning January 1, 2006. The adoption of Interpretation 47 did not have a material impact on the Group's financial position or results of operations.

In March, 2005, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin ("SAB") No. 107, "Share Based Payment." SAB 107 summarizes the views of the SEC staff regarding the interaction between SFAS 123R and certain SEC rules and regulations, and provides the staff's views regarding the valuation of share–based payment arrangements for public companies. The Group adopted SAB 107 concurrently with the adoption of SFAS 123(R) with effect from January 1, 2006. The adoption of SAB 107 did not have a material impact on the Group's financial position or results of operations.

In May 2005, the FASB issued FAS No. 154, "Accounting Changes and Error Corrections", which replaces APB Opinion No. 20, "Accounting Changes" and FAS No. 3, "Reporting Accounting Changes in Interim Financial Statements". FAS No. 154 changes the requirements for the accounting and reporting of a change in accounting principle and is applicable to all voluntary changes and to changes required by an accounting pronouncement if such pronouncement does not specify transition provisions. FAS No. 154 requires retrospective application to the prior periods' financial statements of changes in accounting principle. In cases when it is impracticable to determine the period-specific or cumulative effects of an accounting change, the statement provides that the new accounting principle should be applied as of the earliest period for which retrospective application is practicable or, if impracticable to determine the effect of a change to all prior periods, prospectively from the earliest date practicable. This Statement is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005.

In June 2005, the EITF reached a consensus on EITF Issue No. 05-6, "Determining the Amortization Period for Leasehold Improvements." As part of a business combination, the acquiring entity will often assume existing lease agreements of the acquired entity and acquire the related leasehold improvements. The issues are whether the "lease term" should be reevaluated at consummation of a purchase business combination and whether the amortization period for acquired leasehold improvements should be reevaluated by the acquiring entity in a business combination. The consensus reached by EITF No. 05-6 is effective for leasehold improvements that are purchased or acquired in reporting periods beginning after June 29, 2005.

In October 2005, the FASB issued FASB Staff Position ("FSP") FAS 13-1, "Accounting for Rental Costs Incurred during a Construction Period". Under the provisions of FSP FAS 13-1, lessees may not capitalize rental costs incurred on building or ground operating leases during a construction period. Instead, rental costs should be expensed on a straight-line basis starting at the beginning of the lease term, i.e., when the lessee takes possession of or is given control of the leased property. The provisions of FSP FAS 13-1 are effective starting with the first reporting period beginning after December 15, 2005. The adoption of FSP FAS 13-1 did not have a material effect on the Group's financial position or results of operations.

4. DISCONTINUED OPERATIONS

During 2003, the management of Sistema made a decision to dispose of operations of P-Com, subsidiary of MTU-Inform. In August 2004, MTU-Inform, then affiliate of the Group, sold 83.25% of voting common shares of P-Com to SkyLink, an affiliate of Sistema, for the total cash consideration in amount of $16.0 mln.

In accordance with FAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", the consolidated financial statements of the Group reflect P-Com business as discontinued operations for the year ended December 31, 2004. Accordingly, the Group's share in net income and loss from disposal of P-Com have been excluded from the respective captions in the statement of operations and have been reported as gain or loss from discontinued operations, net of applicable taxes for the year ended December 31, 2004.

5. CASH AND CASH EQUIVALENTS

Cash and cash equivalents as of December 31, 2005 and 2004 consisted of the following:

	2005	2004
Rubles	19,427	24,068
U.S. Dollars	1,018	919
Other currencies	112	28
Cash equivalents	6,926	3,733
Total	**27,483**	**28,748**

Cash and cash equivalents held by the Group with Moscow Bank for Reconstruction and Development ("MBRD"), a subsidiary of Sistema, as of December 31, 2005 and 2004 amounted to $18.7 mln. and $14.5 mln., respectively.

6. SHORT-TERM INVESTMENTS

Short-term investments as of December 31, 2005 and 2004 consisted of the following:

	2005	2004
RUR-denominated time deposits in MBRD	52,116	19,821
USD-denominated time deposits in MBRD	4,600	4,600
P-Com RUR-denominated promissory note	3,822	-
Other non-interest bearing loans to related parties	1,137	1,188
Total	**61,675**	**25,609**

The interest rates of RUR-denominated time deposits in MBRD vary from 6.5% to 7.9%. USD-denominated time deposits in MBRD have the original term of 9 months and bear interest of 7.0% per annum.

RUR-denominated promissory note issued by P-Com is interest-free and matures in 2006. Other non-interest bearing loans mature in 2006.

7. ACCOUNTS RECEIVABLE, ADVANCES AND TAXES RECEIVABLE, NET

Accounts receivable, advances and taxes receivable as of December 31, 2005 and 2004 consisted of the following:

	2005	2004
Customers	25,1	20,6
Related parties, including affiliates, Rostelecom and state-financed institutions	28,5	20,3
Other receivables and advances	21,4	10,6
VAT recoverable	23,9	22,1
Other taxes receivable	2,7	3,1
Allowance for doubtful accounts	(4,1	(1,5
Total	**97,7**	**75,3**

Rostelecom, provider of national long distance and international telecommunications services, is a subsidiary of Svyazinvest, which owns 28% of MGTS voting shares. Svyazinvest is controlled by the Russian government.

Rostelecom pays a fee to MGTS for the transit of domestic long distance and international calls originated by MGTS subscribers. Respective revenue amounts are disclosed in Note 22.

8. PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment as of December 31, 2005 and 2004 consisted of the following:

	2005	2004
Buildings and site improvements	276,27	270,28
Switches and transmission devices	937,78	850,08
Other fixed assets	209,79	210,54
Construction in progress	95,58	89,15
Total cost	1,519,43	1,420,06
Accumulated depreciation	(481,298	(443,100
Total	**1,038,14**	**976,96**

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

Depreciation expense for the years ended December 31, 2005 and 2004 amounted to $73.3 mln. and $69.7 mln., respectively.

9. INTANGIBLE ASSETS, NET

Intangible assets, net of accumulated amortization, as of December 31, 2005 and 2004 consisted of the following:

	December 31, 2005			December 31, 2004		
	Gross carrying value	**Accumulated amortization**	**Net carrying value**	**Gross carrying value**	**Accumulated amortization**	**Net carrying value**
Billing systems	$ 35,765	$ (11,378)	$ 24,387	$ 24,541	$ (7,418)	$ 17,123
Other software	4,184	(1,513)	2,671	3,317	(946)	2,371
Total, net:	**$ 39,949**	**$ (12,891)**	**$ 27,058**	**$ 27,858**	**$ (8,364)**	**$ 19,494**

Amortization expense recorded on intangible assets for the years ended December 31, 2005 and 2004 amounted to $4.8 mln. and $1.5 mln., respectively. Based on the intangible assets existing at December 31, 2005, the estimated amortization expense for each of the five succeeding years and thereafter is as follows:

Year ended December 31,	
2006	$ 7,649
2007	6,539
2008	5,988
2009	3,896
2010	2,021
Thereafter	965
Total	**27,058**

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

10. LONG-TERM INVESTMENTS

Long-term investments as of December 31, 2005 and 2004 consisted of the following:

	2005		2004	
	Ownership, %	**Investment**	**Ownership, %**	**Investment**
Investments in affiliates:				
MTU-Inform	-	-	51	95,062
Comstar UTS	-	-	50	37,691
Telmos	-	-	40	20,108
MTU-Intel	-	-	30	6,736
Total investments in affiliates		-		159,597
Other investees, at cost	Various	6,784	Various	7,090
P-Com RUR-denominated promissory notes		-		3,964
MTU-Intel RUR-denominated promissory note		598		526
Interest free loans to investees		115		155
Total		**7,497**		**171,332**

MGTS and its subsidiaries, MTU-Inform, Comstar UTS, Telmos, MTU-Intel and its subsidiaries collectively represent the fixed line communications business of Sistema. MGTS and its subsidiaries provide the traditional fixed line communication services, while MTU-Inform, Comstar UTS, Telmos, MTU-Intel and its subsidiary provide the alternative fixed line communication services. During the years ended December 31, 2005 and 2004, Sistema performed operational merger of the entities providing the alternative communication services and consolidated its fixed line communication busines under Comstar UTS.

As a part of this corporate restructuring, in November 2005, Comstar UTS issued additional shares to Sistema, MGTS and their subsidiaries. The issue was settled by Sistema's shareholdings in MGTS, MTU-Inform, Telmos and MTU-Intel and MGTS' shareholdings in MTU-Inform, Telmos and MTU-Intel. Upon completion of this transaction, Comstar UTS owns 55.6% of MGTS' common shares and MGTS owns 20.7% of Comstar UTS common shares.

Before November 2005, the Group accounted for its investments in MTU-Inform, Comstar UTS, Telmos and MTU-Intel using the equity method. Starting from November 2005, the Group accounts for its investment in Comstar UTS as a reduction of shareholders' equity.

11. DEBT OBLIGATIONS

Debt obligations as of December 31, 2005 and 2004 consisted of the following:

	Currency	2005	2004
Bonds 5th issue	RUR	52,115	-
Bonds 4th issue	RUR	52,115	54,057
Bonds 3rd issue	RUR	-	36,038
Total corporate bonds		**104,23**	**90,09**
Citibank	USD	21,22	15,14
Vneshtorgbank	Euro	13,10	9,90
Vneshtorgbank	USD	2,92	7,07
Sberbank	RUR	-	12,61
Raiffeisenbank	USD	-	3,75
Guta-bank	USD	-	773
Long-term portion of vendor financing	Various	2,69	9,61
Short-term portion of vendor financing	Various	8,57	16,07
Long-term portion of finance leases	Various	28,66	19,24
Short-term portion of finance leases	Various	12,34	5,27
Total debt		**193,75**	**189,56**
Less amounts maturing within one year		(83,123	(72,278
Total long-term debt		**110,63**	**117,28**

Corporate Bonds - In May 2005, MGTS issued 5-year RUR-denominated bonds (fifth issue) with the face value of 1,500 mln. RUR (equivalent of $52.1 mln. as of December 31, 2005). The bonds carry coupons of 8.3% during the first two years. MGTS made an unconditional offer to repurchase the bonds at par value in May 2007.

In April 2004, MGTS issued 5-year RUR-denominated bonds (fourth issue) with face value of 1,500 mln. RUR (equivalent of $52.1 mln. as of December 31, 2005). The bonds carry coupons of 10% during the first two years. MGTS made an unconditional offer to repurchase the bonds at par value in April 2006. The offer expires on April 27, 2006.

In February 2003, MGTS issued 2-year RUR-denominated bonds (third issue) with the face value of 1,000 mln. RUR (equivalent of $34.7 mln. as of December 31, 2005) due in 2005. The bonds carried a coupon of 12.3% during the first year of trading and of 17.0% during the second year. In February 2005, MGTS has fully repaid the third issue of the bonds.

As of December 31, 2005, the fair value of the bonds was approximately $103.8 mln. and ranged from 99.1% to 100.2% of the principal amount.

Citibank – During the years ended December 31, 2005, 2004 and 2003, MGTS entered into four credit facilities with Citibank for a total amount of $25.1 mln. All facilities bear interest of LIBOR+1.6% and are repayable in 8 semi-annual installments every six months with the last payments in 2008-2010. The facilities were received to finance acquisitions of equipment from STROM telecom, a subsidiary of Sistema. The facilities are collaterized by equipment with approximate carrying amount of $16.9 mln., a deposit of $2.3 mln. in Citibank and are guaranteed by Export Guarantee and Insurance Corporation of the Czech Republic. As of December 31, 2005, the amount outstanding under these facilities was $21.2 mln.

Based on restrictive covenants of the Citibank loan agreements, the Debt to Equity ratio and Debt

Service to Earnings Before Interest and Taxes ("EBIT") ratio of MGTS should not exceed 3:1 and its aggregate debt may not exceed $250.0 mln. The written approval of Citibank is required for MGTS to obtain borrowings individually exceeding $30.0 mln. (apart from Sberbank loan, Raiffeisenbank loan and MGTS bonds) or alienate more than 10% of its assets.

Vneshtorgbank – In March 2005, MGTS entered into a credit agreement with Vneshtorgbank for an amount of Euro 5.3 mln. (equivalent of $6.2 mln. as of December 31, 2005) to finance acquisition of equipment. The loan matures in September 2010 and bears interest at Euribor+5.0% per annum. Equipment with approximate carrying value of $5.7 mln. is pledged to collateralize the outstanding balance under the agreement. As of December 31, 2005, the amount outstanding under the agreement was $6.2 mln.

In July 2004, MGTS entered into two credit agreements for a total amount of Euro 7.3 mln. (equivalent of $8.6 mln. as of December 31, 2005) to finance acquisition of equipment. The loans mature in January 2010 and bear interest at the highest of Euribor+5.4% or 7.5%. Equipment with approximate carrying amount of $7.6 mln. is pledged to collateralize the outstanding balance under the agreement. As of December 31, 2005, the amount outstanding under this credit agreements was $6.9 mln.

During the year ended December 31, 2002, the Group received a number of loans from Vneshtorgbank maturing in 2005-2006 to finance working capital. As of December 31, 2005, amount of $2.9 was outstanding under these loans. The loans are collateralized by equipment with approximate carrying amount of $3.3 mln. The weighted average interest rate on the loans outstanding as of December 31, 2005 was 9.6% per annum.

Sberbank credit facilities - In September 2004, MGTS entered into a credit facility with Sberbank limited to 600 mln. RUR (equivalent of $20.8 mln. as of December 31, 2005) to finance its current assets. The credit facility was fully repaid in June 2005.

In December 2000, MGTS entered into a credit facility with Sberbank for a total amount equivalent to $90.0 mln. to refinance its obligations under Eurobond borrowings. The credit facility was fully repaid in February 2005.

Vendor Financing - Foreign suppliers of telecommunications equipment provide uncollateralized commercial credit to the Group denominated in various currencies on short-term and long-term bases, mostly interest free. The present value of the obligations under vendor financing agreements was determined using the Group's incremental borrowing rate at the date of transaction.

Finance Leases - During 2001-2005, MGTS entered several lease agreements for telecommunications equipment. The agreements expire in 2006-2009 and assume transfer of ownership for equipment to MGTS after the last lease payment is effected. The net book value of leased assets comprised $62.7 mln. and $38.6 mln. as of December 31, 2005 and 2004, respectively, while interest expense for the years ended December 31, 2005 and 2004 amounted to $2.5 mln. and $1.9 mln., respectively.

The following table presents future minimum lease payments under finance leases together with the present value of the net minimum lease payments as of December 31, 2005:

Payments due in the year ended December 31,	
2006	15,8
2007	14,8
2008	11,5
2009	5,5
Total minimum lease payments (undiscounted)	47,8
Less: amount representing interest	(6,8
Present value of net minimum lease payments	41,0
Less: current portion of lease obligations	(12,3
Non-current portion of lease obligations	**28,6**

The weighted average interest rate of all borrowings denominated in currencies other than the Ruble at December 31, 2005 and 2004 was 7.1% and 6.6%, respectively, while it was 9.2% and 12.6%, respectively, for borrowings denominated in RUR. These figures are calculated without taking into account borrowings from related parties, vendor financing arrangements and capital lease agreements.

The debt obligations as of December 31, 2005 have the following maturities:

2006	83,123
2007	25,515
2008	19,743
2009	12,018
2010	53,355
Total	**193,754**

12. ACCOUNTS PAYABLE, TAXES PAYABLE AND ACCRUED LIABILITIES

Accounts payable, taxes payable and accrued liabilities as of December 31, 2005 and 2004 consisted of the following:

	2005	**2004**
Trade accounts payable	7,961	7,137
Accounts payable to related parties	21,651	2,027
Taxes payable	13,261	13,174
Accrued payroll	9,377	8,061
Accrued interest	1,561	3,591
Other liabilities	2,645	5,743
Total	**56,456**	**39,733**

Related party balances as of December 31, 2005 and 2004 are disclosed in Note 22 to the financial statements.

13. DEFERRED REVENUE

Deferred revenue as of December 31, 2005 and 2004 consisted of the following:

	2005	2004
Short-term portion		
Deferred revenue from connection fees	30,968	27,588
Advances from customers	16,996	19,017
Total	**47,964**	**46,605**
Long-term portion		
Deferred revenue from connection fees	109,958	97,538
Total	**109,958**	**97,538**

14. RETIREMENT AND POST-RETIREMENT BENEFITS

MGTS has historically provided certain benefits to employees upon their retirement and afterwards. Currently the main features under the defined benefit pension program include the following:

Monthly regular pension - Employees retiring with at least fifteen years of service receive lifetime payments varying from RUR 3,600 (equivalent of USD 125 as of December 31, 2005) to RUR 50,400 (equivalent of USD 1,751 as of December 31, 2005) per year depending on employee's actual years of service and qualification;

Death-in-service - Lump-sum payment of RUR 15,000 (equivalent of USD 521 as of December 31, 2005), payable upon death of an employee, irrespective of past service;

Lump-sum upon retirement - Lump-sum payment upon retirement of employees with at least five years of service varying from RUR 3,700 (equivalent of USD 129 as of December 31, 2005) to RUR 22,200 (equivalent of USD 771 as of December 31, 2005) depending on employee's actual years of service;

Monthly telephone subsidy - Qualifying pensioners (those who served more than 30 years at MGTS) get 50% subsidy (approximately USD 3.5 per month as of December 31, 2005) for their monthly telephone bills from MGTS;

Death-while-pensioner - MGTS pays lump-sum benefits to relatives of deceased pensioners of up to RUR 10,000 (equivalent of USD 347 as of December 31, 2005).

MGTS' pension obligations are measured as of December 31. The following are the key assumptions used in determining the projected benefit obligation and net periodic pension expense:

Discount rate	9.2%
Future salary increases	9.2%
Future pension increases	0.0%
Average life expectancy of members from date of retirement	17 years

The change in the projected benefit obligation and the change in plan assets are presented in the following table:

	2005	2004
Projected benefit obligation, beginning of the year	13,550	6,034
Service cost	2,914	1,601
Interest cost	1,441	634
Plan amendments	-	4,488
Actuarial losses	2,118	855
Benefit payments	(668)	(433)
Currency translation effect	(487)	371
Projected benefit obligation, end of the year	18,868	13,550
Less: fair value of plan assets	(2,651)	(2,037)
Unfunded status of the plan, end of the year	**16,217**	**11,513**

The increase in projected benefit obligation due to plan amendment in the year ended December 31, 2004 relates to the increase in the base rate used to determine the monthly payments to the retired employees. The changes in the projected benefit obligation due to actuarial losses for the years ended December 31, 2005 and 2004 relate primarily to the changes in the discount rate and employees turnover assumptions.

The accumulated benefit obligation as of December 31, 2005 and 2004 was $16.2 mln. and $11.5 mln., respectively.

The components of the net periodic benefit costs for the years ended December 31, 2005 and 2004 are as follows:

	2005	2004
Service cost	2,914	1,601
Interest cost	1,441	634
Net periodic benefit cost	**4,355**	**2,235**

The Group's management expects contributions to the plan during the year ended December 31, 2006 to amount to $0.9 mln.

The future benefit payments to retirees under the defined benefit plan are expected as follows:

Year ended December 31,	
2006	4,499
2007	1,436
2008	1,370
2009	1,310
2010	1,257
2011-2015	4,365
Thereafter	1,980
Total	**16,217**

15. PROPERTY, PLANT AND EQUIPMENT CONTRIBUTIONS

In the course of its business the Group receives telecommunication infrastructure which is intended to operate as an integral part of the city wire line network from the real estate constructors free of charge as provided by the regulations of the city government. Property, plant and equipment contributions received by the Group during the years ended December 31, 2005 and 2004 were as follows:

	2005	2004
Property, plant and equipment at the beginning of the year	103,82	88,38
Contributions received during the year	6,26	13,59
Currency translation effect	(3,729)	4,99
	106,36	106,97
Deferred revenue amortized	(3,615	(3,156
Property, plant and equipment at the end of the year	**102,74**	**103,82**

16. INCOME TAX EXPENSE

The Group's provision for income tax for the years ended December 31, 2005 and 2004 is as follows:

	2005	2004
Current taxes	45,739	23,552
Deferred taxes	(2,477)	3,070
Total income tax expense	**43,262**	**26,622**

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

	2005	2004
Income tax charge computed on income before taxes at standard tax rate applicable to the Group of 24%	44,1	20,4
Income tax charge on income from affiliates	1,8	1,4
Effect of change in income tax rate attributable to income from affiliates	-	2,0
Currency exchange and translation differences	(1,74	895
Non-deductible expenses	1,2	1,9
Non-taxable income	(2,26	(222)
Income tax expense	**43,2**	**26,6**

Temporary differences between the tax and accounting bases of assets and liabilities give rise to the following deferred tax assets and liabilities at December 31, 2005 and 2004:

	2005	2004
Deferred tax assets		
Accrued operating expenses	4,29	1,72
Post-retirement benefits	3,89	2,76
Property, plant and equipment contributions	24,65	24,91
Deferred revenues	33,82	30,03
Allowance for doubtful accounts	429	3,61
Total	**67,09**	**63,05**
Deferred tax liabilities		
Undistributed earnings of affiliates	(9,33	(8,33
Depreciation of property, plant and equipment	(65,20	(65,13
Other	(318)	(240)
Total	**(74,85**	**(73,71**
Net deferred tax assets, current portion	9,56	11,43
Net deferred tax liabilities, long-term portion	(17,32	(22,09

17. SHAREHOLDERS' EQUITY

Common shares carry voting rights with no guarantee of dividends. Preferred shares carry guaranteed dividend rights amounting to the higher of (a) 10% of the income of MGTS as determined under Russian accounting regulations and (b) the dividends paid on common shares. No dividends may be declared on common shares before dividends on preferred shares are declared. Where the preferred dividend payable according to the Charter is not paid in any year the preferred shares also carry voting rights. At the annual shareholders meeting in June 2005 the payment of a dividend to preferred shareholders was approved.

Preferred shares carry no voting rights except on resolutions regarding liquidation or reorganization of MGTS, changes to dividend levels of preferred shares, or the issuance of additional preferred stock. Such resolutions require two-thirds approval of preferred shareholders. The preferred shares have no rights of redemption. In the event of liquidation, preferred shares have priority over common shares. In this circumstance, holders of preferred shares receive the par value of their shares, or the amounts payable to common shareholders, if higher.

In accordance with the Charter, MGTS is permitted to repurchase, on the open market, up to 10% of its common and preferred shares each year. Repurchased shares must either be sold or cancelled within one year of being purchased.

The distributable earnings of MGTS as of December 31, 2005, as determined under Russian accounting regulations amounted to approximately 11,867 mln. RUR (equivalent of $427.1 mln. as of December 31, 2005).

18. OPERATING REVENUES

Operating revenues for the years ended December 31, 2005 and 2004 consisted of the following:

	2005	2004
Residential		
Voice	226,840	156,094
Payphones	2,383	8,008
Additional telecommunication services	9,230	5,268
Other	2,502	2,061
Corporates		
Voice	129,153	125,403
Access node and trunks rental	33,678	19,215
Additional telecommunication services	12,428	9,907
Other	14,349	7,179
Operators	209,061	147,712
Total	**639,624**	**480,847**

19. OPERATING EXPENSES, NET

Operating expenses for the years ended December 31, 2005 and 2004 consisted of the following:

	2005	2004
Employee costs	177,3	154,5
Depreciation and amortization charge	74,4	68,0
Repairs and maintenance	63,6	59,9
Taxes other than income taxes	25,0	26,0
Utilities and energy	16,7	15,2
Rent	13,5	10,5
Security	11,7	7,7
Bank charges	10,0	8,6
Advertising	9,3	3,0
Consulting and audit	7,2	1,8
Insurance	6,8	6,3
Universal service charge	4,0	-
Transportation	3,9	2,7
Allowance for doubtful accounts	3,3	(500)
Network traffic	-	-
Gain on disposal of long-term investments	(1,9	-
Sundry expenses	20,1	17,1
Total	**445,4**	**381,3**

20. EARNINGS PER SHARE

Earnings per common share have been calculated using the two-class method on the basis of income available for common shareholders, calculated as follows:

	2005	2004
Net income from continuing operations	161,53	74,84
Gain from discontinued operations	-	179
Less: income attributable to preferred shares	(26,922	(12,505
Net income available to common shareholders	**134,61**	**62,52**

If the Group has elected to distribute the total amount of net income for the periods presented, the preferred shareholders of MGTS would be entitled to dividend payments of not less than the per share dividend received by the common shareholders (Note 17). The Group uses this assumption in calculation of earnings per share.

Weighted average number of common shares outstanding was 79,829,200 for the years ended December 31, 2005 and 2004.

21. OPERATING LEASES

(a) As lessor - The Group leases excess office space through operating leases, the majority of which are cancelable. Assets under operating leases are included in property, plant and equipment. The amount of rent income under these agreements is not significant to the Group's results.

(b) As lessee - The land on which the Group's buildings and other facilities are located is owned by the City of Moscow. The Group pays the city rent for the land based on the total area and location of land occupied. Land rental expenses were approximately \$3.2 mln. and \$2.9 mln. for each of the years ended December 31, 2005 and 2004, respectively.

The Group leases buildings, office premises, bridgeworks and collectors mainly from Moscow Government through contracts, which expire in 1 to 20 years. Rental expenses under operating leases are included in the statements of operations (Note 19).

Future minimum lease payments due under non-cancelable leases at December 31, 2005 are:

2006	17,688
2007	11,970
2008	5,501
2009	5,116
2010	4,544
Thereafter	26,867
Total	**71,686**

22. RELATED PARTIES

Related party balances as of December 31, 2005 and 2004 comprised of the following:

	2005	2004
Accounts receivable		
Comstar UTS	19,318	10,489
Rostelecom	3,036	3,910
Central Telegraph	1,319	1,822
Other	4,913	4,132
Total accounts receivable from related parties	**28,586**	**20,353**
Accounts payable		
Sistema Hals	14,511	-
Mediatel	5,711	-
STROM telecom	1,232	1,635
Other	197	392
Total accounts payable to related parties	**21,651**	**2,027**

The Group provides communication services and rents premises to subsidiaries and affiliates of Sistema and Svyazinvest. The following table summarizes revenues received from related parties during the years ended December 31, 2005 and 2004:

	2005	2004
Communication services		
Comstar UTS	95,145	55,635
Central Telegraph	9,336	14,309
Mobile TeleSystems	6,855	5,165
Rent of premises		
Comstar UTS	1,262	8,317
Mobile TeleSystems	1,291	1,142

Rostelecom

MGTS does not provide domestic long-distance and international long-distance, or DLD/ILD, telecommunications services directly to its subscribers, but must route such traffic through a DLD/ILD licensed operator. In 2005 and 2004, the MGTS routed domestic long-distance and international long-distance traffic originated by its subscribers through Rostelecom. Pursuant to agreements with Rostelecom, MGTS received $27.1 mln. and $30.6 mln. for the years ended December 31, 2005 and 2004, respectively. In 2005 and 2004, the Group also purchased communication services from Rostelecom amounting to $1.8 mln. and $1.3 mln., respectively.

Invest-Svyaz-Holding

In 2005 and 2004, the Group entered into agreements with Invest-Svyaz-Holding, a subsidiary of Sistema, for leasing of network equipment and billing system. These leases were recorded as capital leases based on the requirements of SFAS No. 13, “Accounting for Leases.” The present value of future lease payments is reflected as a liability in the balance sheet. Amounts due within one year are classified as current liabilities, and the remaining balance as long-term liabilities. The net book value of assets leased under such agreements as of December 31, 2005 and 2004 was $52.2 mln. and $26.1 mln., respectively. The interest rate implicit in the leases varies from 10% to 14%.

The following table summarizes the future minimum lease payments under capital leases to Invest-Svyaz-Holding together with the present value of the net minimum lease payments as of December 31, 2005.

Payments due in the year ended December 31,	
2006	15,8
2007	14,8
2008	11,5
2009	5,5
Total minimum lease payments (undiscounted)	47,8
Less: amount representing interest	(6,8
Present value of net minimum lease payments	41,0
Less: current portion of lease obligations	(12,3
Non-current portion of lease obligations	**28,6**

For the years ended December 31, 2005 and 2004, the Group paid to Invest-Svayz-Holding $9.7 mln. and $4.8 mln., respectively, in principal and $2.5 mln. and $1.7 mln., respectively, in interest.

Rosno

The Group purchases insurance services from Rosno, a subsidiary of Sistema. The insurance expenses in 2005 and 2004 amounted to $7.2 mln. and $6.1 mln., respectively.

STROM telecom

The Group purchases telecommunications equipment and software from STROM telecom. The cost of equipment and software purchased from STROM telecom in 2005 and 2004 was $8.5 mln. and $10.8 mln., respectively.

Central Telegraph

The Group purchased telecommunications equipment from Central Telegraph, a subsidiary of Svyazinvest. The cost of equipment purchased from Central Telegraph in 2005 and 2004 was nil and $6.4 mln., respectively.

Mediatel

The Group purchases telecommunications equipment and repair and technical maintenance services from Mediatel. The cost of equipment purchased in 2005 and 2004 was $14.0 mln. and $3.4 mln., respectively.

MBRD

During the years ended December 31, 2005 and 2004, the Group kept certain bank and deposit accounts and acquired promissory notes from MBRD, a party related by means of common control. Interest income received from MBRD on bank and deposit accounts during the years ended December 31, 2005 and 2004 amounted to $2.5 mln, and $2.4 mln., respectively.

23. COMMITMENTS AND CONTINGENCIES

Issued Guarantees - In December 2004, MGTS became a guarantor under the credit facility between Sistema Hals and West LB Vostok Bank. The loan of $10.4 mln. matures in December 2007. The guarantee amounted to $10.4 mln. as of December 31, 2005.

MGTS is a guarantor under several credit facilities between Commerzbank (Eurasia) and Invest-Svyaz-Holding. The credit facilities mature in 2006-2008. The guarantees amounted to $20.1 mln. as of December 31, 2005.

Under these guarantees the Group could be potentially liable for a maximum amount of $30.5 mln. in case of borrower's default under the obligations. As of December 31, 2005, no event of default has occurred under any of the guarantees issued by the Group.

Russian Environment and Current Economic Situation - Over the past decade Russia has undergone substantial political and social changes. As an emerging market, Russia does not possess a fully developed business and regulatory infrastructure that would generally exist in a more mature market economy. The current government is attempting to address these issues; however it has not yet fully implemented the reforms necessary to create banking and judicial systems that usually exist in more developed markets. As a result, operations in Russia involve risks that typically do not exist in more developed markets.

Regulations on Telecommunications - On January 1, 2004, a new Law on Telecommunications came into effect in Russia. The law sets the legal basis for the telecommunications business in Russia and defines the status that state bodies have in the telecommunications sector.

According to the new Law on Telecommunications, and effective as of January 1, 2005, all subscribers are required to pay the full price for residential service, and those entitled to discounts are to receive reimbursement from the government rather than discounts from MGTS.

The Law on Telecommunications introduces a Universal Service Fund ("USF") which will result in higher costs for all operators, including the Group. The USF is designed to fund socially important but economically unviable projects. In April 2005, Russian government approved several provisions clarifying how the USF will be collected and administered. Starting July 1, 2005, the amount of the universal service charge is 1.2% of the total revenues received from the usage of public telecommunication network less connection fees and revenues received from interconnection services provided to other operators. For the year ended December 31, 2005, the related expense of $4.0 mln. was recorded in operating expenses.

The Russian government has also issued several implementing acts under the Law on Telecommunications, such as Resolution No. 87, dated February 18, 2005, approving the list of the types of licensed telecommunication activities, and Resolution No. 68, dated February 11, 2005, regarding the rules applicable to the state registration of telecommunication infrastructure such as real property. However, it is presently not yet clear how these regulations would be implemented. Thus, the uncertainty related to the Law on Telecommunications continues.

Taxation Environment - Russian tax legislation is subject to varying interpretations with changes occurring frequently. Further, the interpretation of tax legislation by tax authorities as applied to the transactions and activity of MGTS may not coincide with that of management. As a result, transactions may be challenged by tax authorities and MGTS may be assessed additional taxes, penalties and interest, which can be significant. The periods remain open to review by the tax and customs authorities with respect to tax liabilities for three years.

Management believes that it has adequately provided for tax liabilities in the accompanying consolidated financial statements; however, the risk remains that relevant authorities could take differing positions with regard to interpretive issues.

Contingencies - In the normal course of business, MGTS is subjected to proceedings, lawsuits, and other claims. While such matters are subject to many uncertainties, and outcomes are not predictable with assurance, management of MGTS believes that any financial impact arising from these matters would not be material to its financial position or annual operating results.

During the first half of 2005, MGTS filed seven claims in the Moscow Arbitration Court against the Ministry of Labor and Social Development of the Russian Federation for the recovery of losses it incurred in connection with the provision of communications services in 2003 to 2004 to Russian veterans at a reduced rate. Pursuant to the Federal Law on Veterans, MGTS is seeking full reimbursement from federal funds totaling approximately $15.8 mln. In the second half of 2005, the Arbitration Court ruled in favor of MGTS for the full amount. Although writs of execution have been obtained with respect to four of the seven claims, MGTS has not yet received any payments.

Licenses - Substantially all the Group's revenues are derived from operations conducted pursuant to licenses to operate in Moscow and the Moscow region granted by the Russian Government. The voice phone communication license expires in December 2013. Suspension or termination of the Group's main license or any failure to renew it could have a material adverse effect on the financial position and operations of the Group. However, the Group has no reason to believe that the license will not be renewed or suspended or terminated, and the management estimates the possibility of such events as very low.

Commitments - In December 2005, MGTS entered into an agreement to acquire telecommunications equipment and related services from ECI Telecom (Israel). The vendor financing amounting to $2.3 mln. will bear interest of LIBOR+4% and be repayable in 9 equal quarterly installments starting October 2006.

Interest of the Moscow City Government in the Telecommunications Sector in the Moscow Metropolitan Area - The operations of the telecommunications network in Moscow are of considerable interest to the city government. The city government has exercised and may be expected to continue to exercise influence over the Group's operations. In particular, the city government may influence setting of tariffs charged to customers to protect low income groups, such as pensioners.

24. SUBSEQUENT EVENTS

In December 2005, following the acquisition of the controlling share in MGTS, Comstar UTS made an unconditional offer to repurchase common shares of MGTS from its minority shareholders at the price of 490 RUR (approximately USD 17 as of December 31, 2005) per common share. Under the offer and in a series of transactions in the open market during the first quarter of 2006, Comstar UTS purchased additional 8.1% of the common shares of MGTS for the total cash consideration of $140 mln. increasing its share in common stock of MGTS from 55.6% to 63.7%.

In January 2006, MGTS entered into a credit agreement with Vneshtorgbank limited to Euro 7.4 mln. and bearing interest of EURIBOR+3.75%.

In January 2006, MGTS entered into a credit agreement with Raiffeisenbank limited to $7.9 mln. and bearing interest of LIBOR+3.5%.

In January 2006, the Group established a wholly owned subsidiary MGTS Finance S.A., a legal entity duly incorporated under the laws of Luxembourg. The subsidiary was established to act as a holding company for the Group's investments and a financing vehicle.

In February 2006, Comstar UTS issued additional 139,000,000 of its common shares and completed an initial public offering of 146,500,000 newly issued and existing shares in the form of global depositary receipts ("GDRs"), with one GDR representing one share. The shares were admitted to trade on the London Stock Exchange. As a result of the offering, MGTS's shareholding in Comstar reduced to 13.8%.

In March 2006, MGTS signed an agreement to sell the building recorded as assets held for sale as of December 31, 2005 for the total cash consideration of $26.7 mln.

25. RESTATEMENT

Subsequent to the issuance of the Group’s consolidated financial statements for the year ended December 31, 2005, management performed a recalculation of the Group’s fixed assets register and determined that the historical cost and depreciation of the Group’s property, plant and equipment purchased before July 1994, i.e. the date of the privatization, were not accurate. In addition management of the Group determined that dividends preferred and common shares should be recorded when they are declared. As of January 1, 2004, these errors resulted in an understatement of the gross book value of fixed assets of $3.8 mln., understatement of accumulated depreciation on property, plant and equipment of $36.2 mln., overstatement of deferred tax liabilities of $7.8 mln., overstatement of other liabilities of $9.9 mln. and overstatement of the Group’s retained earnings of $15.7 mln. As a result, the accompanying consolidated financial statements for the year ended December 31, 2004 have been restated from the amounts previously reported. The restatement had no impact on the Group’s net income or cash flows.