Open Joint Stock Company
“VolgaTelecom”

Consolidated Financial Statements

Year ended December 31, 2004
with Independent Auditor’s Report

OJSC “VolgaTelecom”

Consolidated Financial Statements

For the year ended December 31, 2004

Contents

Independent Auditors' Report

To the Shareholders and Board of Directors of OJSC "VolgaTelecom"

1. We have audited the accompanying consolidated balance sheet of OJSC "VolgaTelecom" (a Russian open joint-stock company - hereinafter "the Company"), as of December 31, 2004, and the related consolidated statements of operations, cash flows and changes in shareholders' equity for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

3. As described in Note 2 "Basis of Presentation of the Financial Statements" and Note 5 "Property, Plant and Equipment", the Company has 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 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. However, we were not able to satisfy ourselves as to (i) whether the carrying amounts of property, plant and equipment as at January 1, 2003 are representative of fair value; (ii) resulting depreciation expense for the years presented and (iii) the respective deferred tax balances as of the reporting dates and deferred tax expense for the years presented.

4. As described in Note 3 "Summary of Significant Accounting Policies", the Company has not determined and presented its obligations existing under defined benefit plans in accordance with IAS 19, "Employee Benefits". We were not able to quantify the respective adjustments to the financial statements for the years presented.

5. 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 paragraph 3 above, and except for the effect on the financial statements of the matter referred to in paragraph 4 above, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of OJSC “VolgaTelecom” as of December 31, 2004 and the consolidated results of its operations and its cash flows for the year then ended in conformity with International Financial Reporting Standards.

August 15, 2005

OJSC "VolgaTelecom"

Consolidated Balance Sheet

For the year ended December 31, 2004

(in thousands rubles)

	Notes	2004	2003
ASSETS			
Non-current assets:			
Property, plant and equipment	**5**	**25,603,506**	20,511,639
Intangible assets and goodwill	**6**	**2,167,468**	1,312,823
Investments in associates	**8**	**110,096**	219,080
Long-term investments	**9**	**11,252**	23,619
Long-term accounts receivable and other financial assets	**13**	**21,591**	28,973
Long-term advances given	**10**	**227,798**	133,391
Deferred income tax asset	**28**	**24,814**	54,104
Total non-current assets		**28,166,525**	22,283,629
Current assets:			
Inventories	**11**	**859,609**	502,375
Accounts receivable	**12**	**1,137,874**	1,062,725
Other current assets	**14**	**1,694,769**	1,073,588
Cash and cash equivalents	**15**	**422,185**	327,284
Total current assets		**4,114,437**	2,965,972
TOTAL ASSETS		**32,280,962**	25,249,601
SHAREHOLDERS' EQUITY AND LIABILITIES			
Shareholders' equity:			
Preference shares	**17**	**963,366**	963,366
Ordinary shares	**17**	**2,890,324**	2,890,324
Share premium, retained earnings, and other reserves		**13,199,851**	11,205,113
Total shareholders' equity		**17,053,541**	15,058,803
Minority interest	**18**	**377,213**	345,803
Non-current liabilities:			
Long-term borrowings	**19**	**4,256,346**	2,495,674
Finance lease obligations	**20**	**698,769**	520,394
Deferred revenue		**237,491**	217,720
Deferred income tax liability	**28**	**1,021,603**	1,011,110
Other non-current liabilities		**95,313**	77,860
Total non-current liabilities		**6,309,522**	4,322,758
Current liabilities:			
Accounts payable, accrued expenses and advances received	**21**	**2,592,453**	2,145,616
Payables to Rostelecom	**33**	**110,965**	47,144
Taxes payable	**22**	**845,050**	742,145
Dividends payable	**32**	**28,487**	21,535
Short-term borrowings	**19**	**2,801,307**	1,640,368
Current portion of long-term borrowings	**19**	**1,816,704**	604,320
Current portion of finance lease obligations	**20**	**345,720**	321,109
Total current liabilities		**8,540,686**	5,522,237
Total shareholders' equity and liabilities		**32,280,962**	25,249,601

General Director ______ Omelchenko S.V.   Deputy Chief Accountant ______Voronkova N.P.

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

OJSC "VolgaTelecom"
Consolidated Statement of Operations
for the year ended December 31, 2004

(in thousands rubles, except per share amounts)

	Notes	2004	2003
Revenues	**24**	**20,966,543**	16,726,138
Operating expenses			
Wages, salaries, other benefits and payroll taxes		**(6,735,501)**	(5,258,632)
Depreciation and amortization	**5, 6**	**(2,584,675)**	(2,022,383)
Loss on disposal of property, plant, and equipment		**(78,269)**	(112,350)
Materials, repairs and maintenance, utilities		**(1,787,512)**	(1,545,113)
Taxes other than income tax		**(461,666)**	(272,769)
Interconnection charges		**(2,472,250)**	(1,928,276)
Provision for impairment of receivables	**12**	**(599,653)**	(517,077)
Other operating expenses	**25**	**(2,010,144)**	(1,533,362)
Total operating expenses		**(16,729,670)**	(13,189,962)
Operating profit		**4,236,873**	3,536,176
Share of result of associates	**8**	**72,549**	107,359
Interest expense, net	**26**	**(643,958)**	(398,511)
Gain (loss) from sales of subsidiaries, associates and other investments	**27**	**88,144**	(46,125)
Foreign exchange loss, net		**(14,291)**	(60,388)
Profit before income tax and minority interest		**3,739,317**	3,138,511
Income tax	**28**	**(1,167,257)**	(1,030,215)
Profit before minority interest		**2,572,060**	2,108,296
Minority interest	**18**	**(93,063)**	(111,267)
Net profit		**2,478,997**	1,997,029
Basic and diluted earnings per share (Russian Roubles)	**29**	**7.56**	6.09

General Director_______ Omelchenko S.V. Deputy Chief Accountant _______Voronkova N.P.

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

OJSC "VolgaTelecom"
Consolidated Statement of Cash Flows
for the year ended December 31, 2004

(in thousands rubles)

	Notes	2004	2003
Cash flows from operating activities:			
Profit before income tax and minority interest		**3,739,317**	3,138,511
Adjustments for:			
Depreciation and amortization	**5,6**	**2,584,675**	2,022,383
Loss on disposal of property, plant and equipment		**78,269**	112,350
Provision for impairment of receivables	**12**	**599,653**	517,077
Share of result of associates	**8**	**(72,549)**	(107,359)
(Gain)/loss from sale of subsidiaries, associates and other investments	**27**	**(88,144)**	46,125
Interest expense, net	**26**	**643,958**	398,511
Foreign exchange gain, net		**14,291**	60,388
Operating cash flows before working capital changes		**7,499,470**	6,187,986
Increase in accounts receivable		**(662,830)**	(724,767)
Decrease (increase) in other current assets		**(621,181)**	34,708
Increase in inventories		**(352,798)**	(17,435)
Increase in accounts payable and accrued expenses		**542,094**	89,659
Increase in taxes payable		**104,839**	167,327
Cash flows generated from operations		**6,509,594**	5,737,478
Interest paid		**(535,186)**	(389,820)
Income tax paid		**(1,005,204)**	(945,473)
Net cash flows from operating activities		**4,969,204**	4,402,185
Cash flows from investing activities:			
Purchase of property, plant and equipment		**(6,577,511)**	(3,620,146)
Purchase of intangible assets		**(207,780)**	(716,950)
Proceeds from sales of property, plant and equipment		**99,245**	16,869
Acquisition of subsidiaries and purchase of minority interest		**(249,891)**	(924,840)
Disposal of subsidiaries		**177,686**	–
Proceeds from disposal of investments and other financial assets		**222,309**	–
Interest received		**9,825**	13,089
Dividends received		**38,232**	4,129
Net cash flows used in investing activities		**(6,487,885)**	(5,227,849)
Cash flows from financing activities:			
Proceeds from promissory notes		**396,160**	400,000
Repayment of promissory notes		**(832,037)**	–
Proceeds from borrowings		**7,542,718**	2,504,274
Repayment of borrowings		**(4,007,279)**	(1,658,067)
Proceeds from debt securities issued		**37,428**	988,106
Repayment of finance lease obligations		**(485,308)**	(284,220)
Repayment of vendor financing obligations		**(613,289)**	(633,482)
Proceeds from other non-current liabilities		**–**	11,895
Dividends paid		**(424,811)**	(329,091)
Net cash flows from financing activities		**1,613,582**	999,415
Effects of exchange rate changes on cash and cash equivalents		**–**	(61,330)
Net increase in cash and cash equivalents		**94,901**	112,421
Cash and cash equivalents at the beginning of the year		**327,284**	214,863
Cash and cash equivalents at the end of the year		**422,185**	327,284

General Director_______ Omelchenko S.V. Deputy Chief Accountant ______Voronkova N.P.

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

OJSC “VolgaTelecom”

Consolidated Statement of Changes in Shareholders’ Equity

For the year ended of December 31, 2004

(in thousands rubles)

	Notes	Share capital		Retained earnings	Total equity
		Preference shares	**Ordinary shares**		
At December 31, 2002	**2**	963,366	2,890,324	9,805,524	13,659,214
Net profit for the year		–	–	1,997,029	1,997,029
Purchase of minority interest	**7**	–	–	(276,445)	(276,445)
Dividends	**30**	–	–	(320,995)	(320,995)
At December 31, 2003		963,366	2,890,324	11,205,113	15,058,803
Net profit for the year		**–**	**–**	**2,478,997**	**2,478,997**
Purchase of minority interest	**7**	**–**	**–**	**(57,370)**	**(57,370)**
Dividends	**30**	**–**	**–**	**(426,889)**	**(426,889)**
At December 31, 2004		**963,366**	**2,890,324**	**13,199,851**	**17,053,541**

General Director______ Omelchenko S.V.   Deputy Chief Accountant ________Voronkova N.P.

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

1. General Information

Authorization of Accounts

The consolidated financial statements of OJSC “VolgaTelecom” and its subsidiaries – (hereinafter “the Company” or OJSC “VolgaTelecom”) for the year ended December 31, 2004 were authorized for issue by the General Director of the Company on August 15, 2005.

The Company

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

Open joint-stock company Svyazinvest, a federal holding company majority-owned by the Russian Federation, owns 51% of the Company’s ordinary shares.

The Company’s principal activity is providing local, long-distance and cellular telephone services on the territory of Povolzhie region. Other types of activity of the Company include production of telecommunication equipment and its technical support.

The average number of employees in the Company in 2004 was approximately 50,000 persons (in 2003 – 52,000).

The registered office of the Company is in the city of Nizhny Novgorod (the Russian Federation), Dom Svyazi, Maxim Gorky sq.

Tariff Setting

Under the Russian antimonopoly legislation, the Company is considered a monopolist for fixed line telecommunication services. As a result, tariffs charged by the Company are set by federal authorities. Tariffs charged to the Company by Rostelecom (the primary provider of domestic long distance and international telecommunication services in the Russian Federation, which is also controlled by Svyazinvest) are also subject to state regulation, thus creating a cross-subsidization mechanism.

Liquidity and Financial Resources

As of December 31, 2004, the Company’s current liabilities exceeded its current assets by approximately 4,426,249[Y1] (2003 – 2,556,265[Y2]). As a result, there may be some doubt about the Company’s ability to attract further financing and to pay its existing debts as they fall due.

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

1. General Information (continued)

Liquidity and Financial Resources (continued)

Through 2005, the Company anticipates funding from a) cash generated from operations; b) bonds placement at domestic market; c) financing from domestic and international lending institutions. Management also expects to continue to be able to delay payment for certain operating costs to manage its working capital requirements if necessary.

If needed, management believes that certain projects may be deferred or curtailed in order to fund the Company’s current operating needs.

2. Basis of Presentation of the Financial Statements

Basis of Preparation

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

The Company has transitioned to IFRS at the beginning of the earliest period presented in these financial statements (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 financial statements. The Company's previous financial statements disclosed that management made certain estimates and assumptions to present the carrying value of fixed assets which did not comply with historical cost as defined by IAS 16, “Property, plant, and equipment”.

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.

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.

The Company has also applied the exemption permitted by IFRS 1 which allows an entity to recognize all cumulative actuarial gains and losses at the date of transition even if the corridor approach is used for latter actuarial gains and losses.

Further the Company did not apply the provision of IAS 19 “Employee benefits” and as such did not account for defined benefit obligations. However the Company has engaged an actuary to assess the pension obligation and as a result, the defined benefit obligation will be recorded in subsequent periods.

(in thousands rubles)

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

Accounting for the Effect of Inflation

Prior to January 1, 2003 the characteristics of the economic environment of the Russian Federation indicated the existence of hyperinflation. Non-monetary assets and liabilities acquired prior to December 31, 2002 (except for the property, plant and equipment, for which fair values as at January 1, 2003 have been used as deemed cost), and share capital transactions occurring before December 31, 2002, have been restated in accordance with IAS 29 “Financial Reporting in Hyperinflationary Economies” by applying the relevant conversion factors to the historical cost through December 31, 2002.

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 most significant estimates with regard to those financial statements relate to the valuation and useful lives of property, plant and equipment, deferred taxation and accounts receivable provision, as discussed in Notes 5, 12 and 28.

Reconciliation of Equity and Net Profit Reported under Previous GAAP and under IRFS

Shareholders’ equity and net income are reconciled between previous Generally Accepted Accounting Principles (GAAP) and IFRS as follows:

	Shareholders’ equity as at December 31, 2003	**Net profit for the year ended December 31, 2003**	**Shareholders’ equity as at January 1, 2003**
Previous GAAP as reported	**14,991,936**	**1,792,540**	**13,574,139**
- preference dividends reversal	200,941	–	147,193
- interconnection charges reversal, net of tax effect	70,977	10,630	60,347
- minority interest correction	–	120,175	(120,175)
Previous GAAP as restated	**15,263,854**	**1,923,345**	**13,661,504**
Goodwill amortization	39,522	39,522	
Fair value revaluation of fixed assets, intangible assets and other assets and liabilities in subsidiaries, net of tax effect	31,872	34,162	(2,290)
Purchase of minority interest (Note 7)	(276,445)		
International Financial Reporting Standards	**15,058,803**	**1,997,029**	**13,659,214**

The previous GAAP refers to the Company’s prior year financial statements, in which the Company applied some, but not all, IFRS as described above.

3. Summary of Significant Accounting Policies

3.1 Principles of Consolidation

Subsidiaries

The consolidated financial statements include financial statements of subsidiaries, 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 its operations. Subsidiaries are consolidated from the date on which control is transferred to the Company and are no longer consolidated from the date that control ceases. All intercompany transactions, balances and unrealized gains on transactions between parent and/or subsidiary companies are eliminated. Unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Financial statements of OJSC “VolgaTelecom” and its subsidiaries, based on which the consolidated financial statements are prepared, are based on unified accounting policy.

Acquisition of Subsidiaries

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

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

Minority Interest

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 equity since the date of the combination. Minority interest is presented separately from liabilities and shareholders’ equity.

Acquisition of Minority Interest in subsidiaries

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

3. Summary of Significant Accounting Policies (continued)

3.1 Principles of Consolidation (continued)

Investments in Associates

Associates are entities in which the Company generally owns 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 using the equity method of accounting 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 obligated to make further payments to, or on behalf of, the associate.

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

3.2 Investments

The Company classified its investments into the following categories: held-to-maturity and available-for-sale. Investments with fixed maturity that the management has the intent and ability to hold to maturity are classified as held-to-maturity and are included in non-current assets, except for the cases when they are to be recovered within 12 months after the reporting date. Investments intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, are classified as available-for-sale. These investments are included in non-current assets unless management has the express intention of holding the investment for less than 12 months from the balance sheet date or unless they will need to be sold to raise operating capital, in which case they are included in current assets. Management of the Company determines the appropriate classification of its investments at the time of the purchase and re-evaluates such designation on a regular basis.

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. All investments are initially recognised at cost, being the fair value of the consideration given and including transaction costs.

Available-for-sale investments are carried at fair value. A gain or loss arising from a change in the fair value of an available for sale investment is recognized directly in equity until the investment is sold, collected or otherwise disposed of, or until it is determined to be impaired. Upon disposal, cumulative gain or loss previously recognized as a component of equity is included in the statement of operations.

For investments that are actively traded in organized financial markets, fair value is determined by reference to stock exchange quoted market bid prices at the close of business on the balance sheet date. For investments where there is no quoted market price, fair value is determined by reference to the current market value of another instrument which is substantially the same or is calculated based on the expected cash flows of the underlying net asset base of the investment.

(in thousands rubles)

3. Summary of Significant Accounting Policies (continued)

3.3 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.

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, 2004 and 2003 were as follows:

Currency	2004	2003
Russian Roubles per US dollar	**27.75**	29.45
Russian Roubles per Euro	**37.81**	36.82
Russian Roubles per Japanese yen	**0.27**	0.28

3.4 Property, Plant and Equipment

Property, plant and equipment are recorded at purchase or construction cost less accumulated depreciation and any impairment in value. For the property, plant and equipment acquired prior to January 1, 2003, fair values as at January 1, 2003 have been used as deemed cost (refer to Note 2) in accordance with the exemption provided in IFRS 1.

Depreciation is calculated on a straight-line basis. The depreciation periods, which approximate the estimated useful economic lives of the respective assets, are as follows:

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

For the purposes of disclosure, property, plant and equipment are aggregated into the following groups:

- Land, buildings and constructions;
- Switches and transmission devices;
- Construction in progress and equipment for installation;
- Other assets, in which computers, vehicles and other equipment are included.

3. Summary of Significant Accounting Policies (continued)

3.4 Property, Plant and Equipment (continued)

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.

Construction in progress is recorded as the total of actual expenditures incurred by the Company from the beginning of construction to the reporting date. Depreciation begins when fixed assets are put into operation.

To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset, interest costs on such borrowings, as well as interest costs on borrowings obtained specifically to finance 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.

Repair and maintenance expenditure is expensed as incurred. Major renewals and improvements are capitalized and the assets replaced are retired. Gains and losses arising from the retirement of property, plant and equipment are included in the statement of operations as incurred.

IAS 36 “Impairment of Assets” requires that the recoverable amount of an asset, including property, plant and equipment, should be estimated whenever there is an indication that the assets may be impaired.

The carrying values of property, plant and equipment are reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. If any such indication exists and where the carrying values exceed the estimated recoverable amount, the assets or cash-generating units are written down to their recoverable amount. The recoverable amount of property, plant and equipment is the greater of net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate cash flows, the recoverable amount is determined for the cash-generating unit to which the asset belongs. Impairment losses are recognized in the statement of operations.

3. Summary of Significant Accounting Policies (continued)

3.5 Intangible Assets

Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Company's share of the net assets of the acquired subsidiary/associated undertaking at the date of acquisition. Goodwill on an acquisition of a subsidiary is classified as intangible assets. Goodwill on an acquisition of an associate is included in the investments in associates. Goodwill is not amortized but is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that carrying amount may be impaired. As at the acquisition date, any goodwill acquired is allocated to each of the cash-generating units expected to benefit from the combination's synergies. Impairment is determined by assessing the recoverable amount of the cash-generating unit, to which the goodwill relates. Where recoverable amount of the cash-generating unit is less than the carrying amount, an impairment loss is recognized.

Where goodwill forms part of a cash-generating unit and part of the operations within that unit are 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.

The excess of the fair value of the Company's share of the net assets acquired over the cost of acquisition is recognized in the statement of operations.

Other Intangible Assets

The Company measured GSM licenses at the date of transition to IFRS at the fair value and used that fair value as deemed cost at that date.

Other intangible assets are capitalized at cost.

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

Impairment of Intangible Assets

Where an indication of impairment exists, the carrying amount of any intangible asset is assessed and, when impaired, the asset is written down immediately to its recoverable amount. Intangibles with indefinite lives and those not ready for use are tested for impairment annually or more frequently if events or changes in circumstances indicate that carrying amount may be impaired.

3.6 Inventories

Inventories, which are mainly comprised of cable, materials, spare parts for telecommunications equipment and goods for resale, are recorded at the lower of cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and the estimated costs necessary to make the sale.

Cost of inventory is determined on the weighted average basis.

3. Summary of Significant Accounting Policies (continued)

3.7 Accounts Receivable

Accounts receivable are stated at original invoice amount, less provision made for impairment of these receivables. A provision for impairment of trade receivables and other receivables is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of receivables.

Accounts that are individually significant are assessed for uncollectability and recognized individually. Uncollectability is measured and recognized on a portfolio basis for accounts of similar customers that are not individually identified as doubtfully recoverable.

The amount of the provision is recognized in the statement of operations.

3.8 Value-Added Tax

The tax regulations permit the settlement of sales and purchases value added tax (VAT) on a net basis.

Value added tax receivable

VAT recoverable relates to purchases which have not been settled at the balance sheet date. VAT receivable is reclaimable against sales VAT upon payment for the purchases.

Value added tax payable

Value added tax payable comprises the following: 1) VAT related to sales, which is payable to tax authorities upon collection of receivables from customers net of VAT on purchases which have been settled at the balance sheet date; 2) VAT related to sales which have not been settled at the balance sheet date (VAT deferred). Where provision has been made for impairment of receivables, impairment loss is recorded for the gross amount of the debtor, including VAT. The related VAT deferred liability is maintained until the debtor is written off for tax purposes.

3.9 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.

3.10 Borrowings

Borrowings are initially recognized at cost, being the fair value of the consideration received, net of transaction costs incurred. In subsequent periods, borrowings are measured at amortized cost using the effective interest rate method; any difference between the fair value of the consideration received (net of transaction costs) and the redemption amount is recognized as interest expense over the period of the borrowings.

3. Summary of Significant Accounting Policies (continued)

3.11 Leases

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

Capitalized leased assets are depreciated using the straight-line method over the estimated useful life of the asset like other fixed assets within the same class, with consideration of the lease term.

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

3.12 Pensions and Other Post-Employment Benefits

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 35.6% to approximately 18%) to the annual gross remuneration of each employee. The Company allocates the UST to three social funds (state pension fund, social and medical insurance funds), where the rate of contributions to the pension fund vary from 28% to 14% depending on the annual gross salary of each employee.

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

Other pension plans and post-employment benefits

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

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

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.

3. Summary of Significant Accounting Policies (continued)

3.13 Deferred Income Tax

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 base of assets and liabilities and their carrying values for financial reporting purposes.,

A deferred tax asset is recorded only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilized. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realized or the liability is settled, based on tax rates that have been enacted (or substantively enacted) at the balance sheet date.

Deferred income tax is provided on temporary differences arising on investments in 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.

3.14 Provisions

Provisions are recognized when the Company has a present legal or constructive obligation as a result of past events, and 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, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain.

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

3.15 Shareholders' Equity

Share capital

Ordinary shares and non-redeemable preference shares with discretionary dividends are both classified as equity. External costs directly attributable to the issue of new shares, other than on a business combination, are shown as a deduction in equity from the proceeds. Any excess of the fair value of consideration received over the par value of shares issued is recognized as a share premium.

Dividends

Dividends are recognized as a liability and deducted from equity at the balance sheet date only if they are declared 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)

3.16 Revenue

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

The Company categorizes the revenue sources in thirteen major categories:
1. Long distance telephone calls - domestic;
2. Long distance telephone calls - international;
3. Local telephone calls;
4. Installation and connection fees;
5. Documentary services;
6. Cellular services;
7. Radio and TV broadcasting;
8. Data transfer and telematics services;
9. New services;
10. Rent of telephone channels;
11. Services for national operators;
12. Other telecommunications services;
13. Other revenues.

Long distance calls (domestic and international)

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

Local telephone calls

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

Installation and connection fees

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

3. Summary of Significant Accounting Policies (continued)

3.16 Revenue (continued)

Documentary services

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

Cellular services

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

Radio and TV broadcasting

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

Data transfer and telematics services

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

New services

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

Rent of telephone channels

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

Services for national operators

Revenue from national service providers includes two different groups.

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

3. Summary of Significant Accounting Policies (continued)

3.16 Revenue (continued)

Services for national operators (continued)

In 2003 the Ministry of the Russian Federation for antimonopoly policy and entrepreneurial support (MAP) has conducted a reform of the settlements system of multi regional OJSC “Svyazinvest” Companies with the OJSC “Rostelecom” for transit of intercity long-distance traffic. Till August 1, 2003 revenue calculation has been based on the integral settlement rate, multiplied on the total number of minute-distances (transfer of 1 minute of traffic on 50 kilometres interval of OJSC “Rostelecom”’s network), transferred through the period.

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

In August 2003 new and more transparent inter-operators settlement system for intercity traffic has been introduced. New system separates payments of regional operators for the transfer of intercity traffic in OJSC “Rostelecom”’s network and termination of the traffic in the zone, where outgoing intercity call of own subscriber reaches its destination, and payments for the termination of the incoming intercity traffic from other operators in the own network of the Company.

Calculation of the costs for the transit of intercity traffic is based on the new settlement rate, that is equal to the sum of linear settlement rate multiplied by the quantity of 50 kilometres intervals between zones, using the termination settlement rate for the zone where the calls is terminated. Revenue calculation for the transit of intercity traffic from the OJSC “Rostelecom”’s to the customers of the regional OJSC “Svyazinvest”’s company is based on the termination settlement rates. New rates have been defined by the order of the MAP dated July 4, 2003.

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

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

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

3. Summary of Significant Accounting Policies (continued)

3.16 Revenue (continued)

Other telecommunication services

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

Other revenues

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

3.17 Commitments

A commitment is a binding agreement for the exchange of a specified quantity of resources at a specified price on a specified future date or dates.

Significant commitments are disclosed.

Assets to be acquired and liabilities to be incurred as a result of the Company's commitment to purchase or sell goods or services are not recognized until at least one of the parties has performed under the agreement such that it either is entitled to receive an asset or is obligated to disburse an asset.

3.18 Contingencies

Contingent liabilities are not recognized in the financial statements as it is not probable that a liability will need to be settled or the outcome to determine whether a liability exists is dependant on a future event. They are disclosed in the accompanying notes unless the possibility of an outflow of resources embodying economic benefit is remote.

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

3.19 IFRS 3 'Business Combinations', IAS 36 'Impairment of Assets' and IAS 38 'Intangible Assets'

The company has chosen an early adoption of IFRS 3, IAS 36 and IAS 38 with provisions of these standards to be applied to business combinations for which the agreement date was on or after January 1, 2003.

(in thousands rubles)

4. Segment Information

	2004				2003			
	Fixed line	**Mobile**	**Intercompany eliminations**	**Total for the Company**	**Fixed line**	**Mobile**	**Intercompany eliminations**	**Total for the Company**
REVENUE								
Sales to third parties	**18,628,219**	**2,736,677**	**(398,353)**	**20,966,543**	14,893,218	2,077,025	(244,105)	16,726,138
Inter-segment sales	**(350,122)**	**(48,231)**	**398,353**	**–**	(244,105)		244,105	–
Total revenue	**18,278,097**	**2,688,446**	**–**	**20,966,543**	14,649,113	2,077,025	–	16,726,138
Segment result	**3,467,963**	**768,910**		**4,236,873**	2,797,786	738,390		3,536,176
Unallocated corporate expenses	**–**	**–**		**–**	–	–		–
Operating profit				**4,236,873**				3,536,176
Share of result of associates				**72,549**				107,359
Interest expense, net				**(643,958)**				(398,511)
Gain (loss) from sale of subsidiaries, associates and other investments				**88,144**				(46,125)
Foreign exchange gain, net				**(14,291)**				(60,388)
Income tax				**(1,167,257)**				(1,030,215)
Minority interest				**(93,063)**				(111,267)
Net profit				**2,478,997**				1,997,029

(in thousands rubles)

4. Segment Information (continued)

	2004				2003			
	Fixed line	**Mobile**	**Intercompany eliminations**	**Total for the Company**	**Fixed line**	**Mobile**	**Intercompany eliminations**	**Total for the Company**
OTHER INFORMATION								
Segment assets	**29,656,339**	**2,559,539**	**(69,826)**	**32,146,052**	21,952,837	3,023,580	–	24,976,417
Investments in associates				**110,096**				219,080
Unallocated corporate assets				**24,814**				54,104
Consolidated total assets				**32,280,962**				25,249,601
Segment liabilities	**(12,392,028)**	**(1,506,403)**	**69,826**	**(13,828,605)**	(7,652,610)	(1,181,275)	–	(8,833,885)
Unallocated corporate liabilities				**(1,398,816)**				(1,356,913)
Consolidated total liabilities				**(15,227,421)**				(10,190,798)
Capital expenditure	**6,938,434**	**1,054,559**		**7,992,993**	4,334,951	732,970		5,067,921
Depreciation and amortization	**2,279,741**	**304,934**		**2,584,675**	1,787,597	234,786		2,022,383
Other non-cash expenses (provision for impairment of receivables)	**583,118**	**16,535**		**599,653**	494,087	22,990		517,077

(in thousands rubles)

4. Segment Information (continued)

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

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

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

5. Property, Plant and Equipment

	Land, buildings and constructions	Switches and transmission devices	Construction in progress and equipment for installation	Vehicles and other	Total
Cost					
At December 31, 2003	9,397,798	9,317,555	1,338,461	2,443,002	22,496,816
Additions	–	–	7,992,993	–	7,992,993
Additions due to acquisition of subsidiaries	–	7,481	–	–	7,481
Disposals	(95,410)	(75,126)	(10,296)	(61,804)	(242,636)
Disposals due to sale of subsidiaries	(72,800)	(96,262)	(40,322)	(10,059)	(219,443)
Transfers	3,038,062	3,439,274	(7,551,922)	1,074,586	–
At December 31, 2004	**12,267,650**	**12,592,922**	**1,728,914**	**3,445,725**	**30,035,211**
Accumulated Depreciation					
At December 31, 2003	(470,480)	(1,124,166)	–	(390,531)	(1,985,177)
Charge for the year	(551,538)	(1,444,350)	–	(526,022)	(2,521,910)
Disposals	7,751	29,263	–	11,982	48,996
Disposals due to sale of subsidiaries	5,144	14,803	–	6,439	26,386
At December 31, 2004	**(1,009,123)**	**(2,524,450)**	**–**	**(898,132)**	**(4,431,705)**
Net book value as of December 31, 2003	8,927,318	8,193,389	1,338,461	2,052,471	20,511,639
Net book value as of December 31, 2004	**11,258,527**	**10,068,472**	**1,728,914**	**2,547,593**	25,603,506

The net book value of property, plant and equipment, which were received on vendor financing terms, amounted as of December 31, 2004 to 1,503,318 [Y3](2003 – [Y4]1,428,608).

The net book value of plant and equipment held under finance leases at December 31, 2004 is 1,675,050 [Y5](2003 – 1,202,206[Y6]). Leased assets are pledged as security for the related finance lease obligations (see Note 20).

In 2004, the Company increased construction in progress by the amount of capitalized interest totalling 183,613 [Y7](2003 – 131,178[Y8]). Capitalization rate in 2004 was 12%[Y9].

(in thousands rubles)

5. Property, Plant and Equipment (continued)

Bank borrowings are secured by properties with the carrying value as of December 31, 2004 of approximately 8,918,000 [Y10](2003 – 5,361,[Y11]000) (see Note 19).

The net book value of property plant, plant and equipment which were subject to joint ownership as of December 31, 2004 amounted to 81,256 (2003 – 78,133).

6. Intangible Assets

	Goodwill	Licenses	Software	Other	Total
Cost					
At December 31, 2003	323,811	167,055	737,074	125,577	1,353,517
Additions	–	14,325	901,833	306	916,464
Additions due to acquisition of subsidiaries	1,286	–	19	–	1,305
Disposals	–	–	(2,557)	(120)	(2,677)
Disposals due to sale of subsidiaries	–	–	(202)	–	(202)
At December 31, 2004	**325,097**	**181,380**	**1,636,167**	**125,763**	**2,268,407**
Accumulated amortization					
At December 31, 2003	–	(13,937)	(16,072)	(10,685)	(40,694)
Charge for the year	–	(17,490)	(32,294)	(12,981)	(62,765)
Disposals	–	–	2,495	12	2,507
Disposals due to sale of subsidiaries	–	–	13	–	13
At December 31, 2004	**–**	**(31,427)**	**(45,858)**	**(23,654)**	**(100,939)**
Net book value at December 31, 2003	323,811	153,118	721,002	114,892	1,312,823
Net book value at December 31, 2004	**325,097**	**149,953**	**1,590,309**	**102,109**	**2,167,468**

Goodwill arose on the acquisition of CJSC “Transsvyaz” on August 20, 2004 (see Note 7).

Oracle E-Business Suite

As of December 31, 2004 software includes Oracle E-business Suite software with a gross book value of 845,558[Y12] (2003 – 684,616), including interest capitalized of 76,934 (2003 – nil[Y13]). In accordance with the supply contract, the Company has been provided with non-exclusive licenses for 13,029 users of E-business Suite 2003 Professional among other license applications.

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 useful life of the licenses. Until then the Company annually tests this software for impairment.

Full implementation of Oracle E-Business Suite software is expected to be between 2005 and 2008.

Advances given to acquire Oracle E-Business Suite software in the amount of 44,293 are included in “Long-term advances given” (see Note 10).

6. Intangible Assets (continued)

Amdocs Billing Suite

As of December 31, 2004 software also includes Amdocs Billing Suite software with a gross book value of 645,579 [Y14](2003 – nil). This software was purchased for the purpose of the implementation of unified automated settlements system. The project of implementation of the unified automated settlements system is expected to last 4-5 years.

The Company’s Board of Directors approved the purchase of Amdocs Billing Suite software on November 22, 2004[Y15].

Amdocs Billing Suite software was supplied in December 2004 by LLC IBM Eastern Europe/Asia, in exchange for zero coupon promissory notes in the amount of 755,662. Repayment of promissory notes issued is expected to be exercised by June 1, 2006[Y16].

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

The Company’s management believes that the carrying values of goodwill, Oracle E-business Suite software and Amdocs Billing Suite software are recoverable as of December 31, 2004 and 2003.

As of December 31, 2004 licenses mainly included GSM 900 licenses with net book value 149,953 (2003 – 153,118). The Company measured GSM licenses at the date of transition to IFRS at fair value and used that fair value as deemed cost at that date. The remaining useful life of licenses is approximately about 8 years.

(in thousands rubles)

7. Consolidated Subsidiaries

The consolidated financial statements include the assets, liabilities and financial results of OJSC “VolgaTelecom” and its subsidiaries, whose main activity is providing cellular and other telecommunication services. These subsidiaries are Russian legal entities registered in accordance with Russian regulations. The subsidiaries are listed below:

Subsidiary	Main Activity	Ownership,% 2004	Ownership,% 2003	Voting Shares 2004	Voting Shares 2003
CJSC “Nizhegorodskaya Sotovaya svyaz” (NCC)	Cellular services (GSM-900)	**100**	100	**100**	100
CJSC “Tsifrovye Telecommunicatsii”	Local telephone network services	**100**	100	**100**	100
CJSC “Telesvyazinform”	Cable and air TV services	**100**	100	**100**	100
LLC Russian-American SP “Izhcom”	Data transmission and telematics services	**100**	51	**–**	–
LLC “Vyatka-Page”	Paging services	**91**	91	**–**	–
CJSC “Transsvyaz”	Local telephone network services	**80**	40	**80**	40
CJSC “Omrix”	Local telephone network services	**74**	42	**74**	42
CJSC “Puls Radio Ioshkar-Iola”	Radio services	**61**	61	**61**	61
CJSC “Ulianovsk –GSM”	Cellular services (GSM-900)	**60**	51	**60**	51
CJSC “Sotovaya svyaz Mordovii”	Cellular services (GSM-900)	**60**	60	**60**	60
CJSC “Orenburg GSM”	Cellular services (GSM-900)	**51**	51	**51**	51
LLC “RadioResonans”	Radio services	**51**	51	**–**	–
OJSC “Tatincom-T”	Cellular services (GSM-900)	**50 + 1 share**	50 + 1 share	**50 + 1 share**	50 + 1 share
CJSC “Narodny Telephone Saratov”	Cellular services (CDMA)	**50 + 1 share**	50 + 1 share	**50 + 1 share**	50 + 1 share
CJSC “Nizhegorodsky radiotelephone”	Local telephone network services	**50**	50	**50**	50
CJSC “Chery - Page”	Paging services	**50**	50	**50**	50
LLC “Vyatskaya sotovaya svyaz”	Cellular services (NMT-450)	**–**	51	**–**	–
LLC “Udmurtskie sotovye seti - 450"	Cellular services (NMT-450)	**–**	100	**–**	–

In March 2003, the Company acquired minority interests of 50% in CJSC “Nizhegorodskaya Sotovaya Svyaz” for cash consideration of 20 million US dollars (approximately 641,000) and became 100% owner of this entity. The difference between the cost of the additional interest in the subsidiary and the minority interest’s share of the assets and liabilities in total amount of 276,445 was reflected as an equity transaction.

In September 2003 the Company acquired 50%+1 share in OJSC “Tatincom-T” for consideration of 15.6 million US dollars (approximately 474,000).

(in thousands rubles)

7. Consolidated Subsidiaries (continued)

The Company's management has assigned the acquisition price for the 50%+1 share in OJSC "Tatincom-T" as follows:

Acquisition price	454,656
Transaction costs	19,280
Total paid	473,936
Assigned value of identifiable assets and liabilities:	
Property, plant and equipment, net	437,783
Intangible assets, net	102,886
Accounts receivable	78,837
Cash and cash equivalents	8,628
Other current assets	133,747
Current liabilities	(213,273)
Long-term liabilities	(248,358)
Total net assets	300,250
Company's share in acquired net assets	50%
Assigned value of acquired share in identifiable net assets	150,125
Amount of goodwill at December 31, 2003, net	**323,811**

On January 15, 2004 the Company acquired additional 31.2% of ordinary voting shares of OJSC "Omrix" for cash consideration 406 and obtained control over this entity (increased it's share to 74%). The fair value of OJSC "Omrix"'s identifiable assets, liabilities and contingent liabilities approximated the book values. The difference between the cost of the acquisition and the acquired share of the assets and liabilities constituted the amount of 27 (see also Note 8).

On July 16, 2004 the Company acquired additional 40% of ordinary shares of CJSC "Transsvyaz" for cash consideration 3,990 and obtained control over this entity (increased it's share to 80%). The fair value of CJSC "Transsvyaz"'s identifiable assets, liabilities and contingent liabilities approximated the book value. The difference between the cost of the acquisition and the acquired share of the assets and liabilities constituted the amount of 1,259 (see also Note 8).

On September 27, 2004 the Company acquired 9% minority interest in CJSC "Ulyanovsk-GSM" for cash consideration 62,115 (increased it's share to 60%). The difference between the cost of the additional interest in the subsidiary and the minority interest's share of the assets and liabilities in the amount of 42,915 was reflected as an equity transaction.

On May 18, 2004 the Company acquired all minority interest in LLC Russian-American SP "Izhcom" for cash consideration 23,266 and became 100% owner of this entity. The difference between the cost of the additional interest in the subsidiary and the minority interest's share of the assets and liabilities in total amount of 14,455 was reflected as an equity transaction.

(in thousands rubles)

7. Consolidated Subsidiaries (continued)

Disposal of shares in subsidiaries for 2004 is presented below:

Name	Main activity	Carrying amount of net assets disposed	Sale/disposal of share in equity on the date of transaction, %	Proceeds from sale
LLC Vyatskaya sotovaya svyaz"	Cellular services (NMT-450)	33,205	51	45,698
LLC "Udmurtskie sotovye seti – 450"	Cellular services (NMT-450)	89,863	100	134,170
Total		**123,068**		**179,868**

Profit / loss on sale of shares in subsidiaries is presented in Note 27.

8. Investments in Associates

Investments in associates at December 31, 2004 and 2003 comprised the following:

		As of December 31, 2004		As of December 31, 2003	
Associate	**Activity**	**Voting shares**	**Carrying value**	**Voting shares**	**Carrying value**
CJSC "Tsifrovye Seti Udmurtii-900"	Cellular services (GSM-900)	–	–	49%	120,320
CJSC "Samara Telecom"	Local telephone network services	**28%**	**77,695**	28%	64,583
CJSC "Transsvyaz"	Local telephone network services	–	–	40%	1,196
OJSC "Telesot"	Local telephone network services	**32%**	**10,248**	32%	9,093
ACB "S-Bank"	Banking services	**42%**	**16,596**	42%	16,944
OJSC "Omrix"	Local telephone network services	–	–	42%	508
Other	Cellular and telephone services	**40%–49%**	**5,557**	20%–49%	6,436
Total			**110,096**		**219,080**

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

The Company has investments in the following associates whose net assets are negative as of December 31, 2004 and 2003:

Name	Activity	Voting share, %	Net assets as of December 31, 2004	Net assets as of December 31, 2003
CJSC "Saratov-Mobile"	Cellular services (AMPS)	50%	**(75,537)**	(51,089)
CJSC "Chuvashiya Mobile"	Cellular services (AMPS)	30%	**(2,251)**	(53,824)

(in thousands rubles)

8. Investments in Associates (continued)

Disposal of shares in associates for 2004 is presented below:

Associate	Main activity	Carrying value of associate	Sale/disposal of share in equity on the date of transaction, %	Proceeds from sale
CJSC "Sotel-NN"	Cellular services (NMT-450)	–	20%	17,883
CJSC "Tsifrovye Seti Udmurtii-900"	Cellular services (GSM-900)	178,294	49%	186,729
Total		**178,294**		**204,612**

The share of income from CJSC "Tsifrovye Seti Udmurtii" for the period beginning January 1, 2004 to the date of disposal was 57,975[Y17].

Gain from sale of shares in associates is presented in Note 27.

Movement in investments in associates for the years ended December 31, 2004 and 2003 is presented below:

	2004	2003
Investments in associates at January 1	**219,080**	111,721
Share of income net of income tax, net of dividends received	**72,549**	107,359
Effect of consolidation as a result of acquisition of control	**(3,239)**	–
Sale of investments in associates	**(178,294)**	–
Investments in associates at December 31	**110,096**	219,080

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 CJSC "Saratov-Mobile", and CJSC "Chuvashiya Mobile". 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.

9. Long-term investments

As of December 31, 2004 and 2003, the Company's investments comprised the following:

	2004	2003
Long-term investments available-for-sale	**11,252**	23,619

(in thousands rubles)

9. Long-term investments (continued)

As of December 31, 2004 and 2003 financial investment available-for-sale comprised the following:

Company	2004 Carrying value	2004 Ownership interest	2003 Carrying value	2003 Ownership interest
ZAO "RusleasingSvyaz"	**12,293**	**7.7%**	12,293	7.7%
OAO "Promstroybank"	**7,496**	**0.7%**	7,496	0.7%
OAO "AlfaBank" promissory notes	**2,583**	–	2,583	–
OAO "Svyaz-bank"	**3,987**	**2.1%**	3,987	2.1%
OAO "Sberbank RF"	**803**	**0.00061%**	803	0.00061%
OAO "Ayar"	**443**	**0.23%**	443	0.23%
ZAO "TeleRoss-Samara"	**990**	**10.0%**	990	10.0%
TOO "Raduga-poisk"	**3,079**	**10.0%**	3,079	10.0%
"Union-Card"	**402**	**15.0%**	402	15.0%
ZAO "Reg-time"	**570**	**18.0%**	570	18.0%
OAO "ONEXIM-Volga"	–		14,806	8.0%
OAO "Mordovpromstroybank"	–		5,051	6.0%
Regional trade centre "Myza"	–		6,081	3.0%
Others	**1,803**		4,133	
Impairment provision	**(23,197)**		(39,098)	
Total	**11,252**		**23,619**	

10. Long-Term Advances Given

As of December 31, 2004 and 2003 long-term advances given to suppliers of equipment comprised the following:

	2004	2003
Advances given for capital constructions	**183,505**	133,391
Acquisition of Oracle E-Business Suite software (Note 6)	**44,293**	–
Total	**227,798**	133,391

11. Inventories

Inventories at December 31, 2004 and 2003 comprised the following:

	2004	2003
Cable, materials and spare parts for telecommunications equipment	**592,913**	290,957
Finished goods and goods for resale	**39,226**	33,920
Other inventories	**227,470**	177,498
Total	**859,609**	502,375

(in thousands rubles)

12. Accounts Receivable

Accounts receivable as of December 31, 2004 and 2003 comprised the following:

	2004	2003
Trade receivables – telecommunication services	**2,449,797**	1,823,256
Provision for impairment of receivables	**(1,311,923)**	(760,531)
Total	**1,137,874**	1,062,725

The Company identified accounts receivable for telecommunication services by the following major customer groups:

	2004	2003
Residential customers	**800,840**	678,171
Corporate customers	**406,215**	399,574
Government customers, including tariff compensation from the state budget	**1,242,742**	745,511
Total	**2,449,797**	1,823,256

The Company invoices its governmental and corporate customers on a monthly basis. For residential customers, the Company sends monthly payment requests and substantially relies upon these customers to remit payments based on the received payment requests. All customer payments are based upon tariffs, denominated in roubles, in effect at the time the calls are made. In certain cases the Company managed to collect penalties for payment delays and to enforce reimbursement in arbitration court.

Prior to January 2005, telecommunication services provided to privileged customers, which are individuals that the government has agreed to provide certain benefits, was compensated 50% by the state budget and the other 50% paid by the privilege subscribers themselves.

Article 47 of the Federal Law "On Telecommunications" No. 126-FZ dated July 7, 2003 is effective starting from 2005, which amends the rules on providing telecommunication services to privileges customers. Starting from January 2005 telecommunication customers with the right of privileges are obliged to pay for telecommunication services in full with the subsequent reimbursement of their expenses by the state budget. However, in 2005 state budget does not provide for financing of the remaining debt of social security organizations to compensate expenses related to granting privileges to certain category of subscribers in the previous periods.

As of December 31, 2004 debt of social security organizations with regard to compensation of expenses related to granting privileges to certain category of subscribers amounted to 44% of total accounts receivable (2003 - 32%). [TT18]

In 2004 the Company collected from federal budget accounts receivable of 221,878. In December 2004, based on assessment of probability of judicial recovery of accounts receivable related to compensation due from social security organizations, the Company has accrued provision for impairment of receivables of 1,071,065 representing 100% of total receivables from social security organizations as of December 31, 2004.

(in thousands rubles)

12. Accounts Receivable (continued)

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

	2004	2003
Balance at January 1	**760,531**	243,454
Provision (recovery) for the year	**599,653**	517,077
Trade receivables write-off	**(44,681)**	–
Provision disposal due to sale of subsidiary	**(3,580)**	–
Balance at December 31	**1,311,923**	760,531

13. Long-Term Accounts Receivable and Other Financial Assets

As of December 31, 2004 and 2003, long-term accounts receivable and other financial assets included:

	2004	2003
Long-term accounts receivable	**3,308**	4,346
Long-term loans given to employees	**18,283**	24,627
Total	**21,591**	**28,973**

14. Other Current Assets

As of December 31, 2004 and 2003 other current assets comprised the following:

	2004	2003
VAT receivable	**1,128,487**	693,093
Prepaid income tax	**42,203**	59,606
Prepayments and advance payments	**151,638**	104,065
Deferred expenses	**106,449**	97,278
Short-term loans given	**3,743**	5,026
Other prepaid taxes	**31,702**	18,358
Settlements with personnel	**23,286**	23,958
Other	**207,261**	72,204
Total	**1,694,769**	1,073,588

15. Cash and Cash Equivalents

As of December 31, 2004 and 2003 cash and cash equivalents comprised the following:

	2004	2003
Cash at bank and on hand	**420,990**	278,480
Short-term deposits with maturity up of three months	**182**	47,075
Cash equivalents	**1,013**	1,729
Total cash and cash equivalents	**422,185**	327,384

(in thousands rubles)

16. Significant Non-Cash Transactions

In 2004 the Company received telecommunication equipment under leasing terms in the amount of 593,878 [Y19](in 2003 – 709,823[Y20]).

During 2004 the Company purchased Amdocs Billing Suite for 721,394[Y21]. This purchase was financed through issuance of promissory notes with maturity in 2005 – 2006.

Gross book value of property, plant and equipment, which were received on vendor financing terms in 2004, amounted to 400,849[Y22] (2003 – 512,197).

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

17. Share Capital

As at December 31, 2004 and 2003 the authorized numbers of ordinary and preference shares were 245,969,590 and 81,983,404, respectively.

All shares have a par value of 5 Roubles. The difference between the total par value and the total carrying value of share capital represents the effects of inflation in periods prior to January 1, 2003.

Type of share	Number of outstanding shares (thousands)	Par value per one share (roubles)	Total par value	Carrying value
Ordinary	245,970	5	1,229,848	2,890,324
Preference	81,983	5	409,917	963,366
Total	**327,953**		**1,639,765**	**3,853,690**

The ordinary shareholders are entitled to one vote per share. Class A preference shares give the holders the right to participate in general shareholders' meetings without voting rights except in instances where decisions are made in relation to re-organization and liquidation of the Company, and in relation to changes and amendments to the Company's charter which restrict the rights of preference shareholders. The preference shares have no rights of redemption or conversion but carry non-cumulative dividends per share of 10% of the Russian accounting net income for the year. If the Company fails to pay the above mentioned dividends, or has no profits in any year, the preferred shareholders have the right to vote in the general shareholders' meeting.

Annual amount of dividends on preference shares class A may not be less than dividends on ordinary shares. The preference shareholders share in earnings along with ordinary shareholders. Accordingly the preference shares are considered participating shares for the purpose of the calculation of earnings per share (Note 29).

(in thousands rubles)

17. Share Capital (continued)

In October 1997 the Company registered Level 1 American Depositary Receipts (ADR). Each ADR represents 2 shares of common stock of the Company. As at December 31, 2003 the Company has 12,757,592[Y23] ADR equal to 25,515,184 [Y24]ordinary shares that represent 10.37% of ordinary shares and 7.78[Y25]% of the Charter Capital. During 2004 the Company registered additional 4,900,278 ADR equal to 9,800,556[Y26] ordinary shares. As at December 31, 2004 the Company has 17,657,870 [Y27]ADR equal to 35,315,740[Y28] ordinary shares that represent 14.36[Y29]% of ordinary shares and 10.77[Y30]% of the Charter Capital.

Dividends were declared in 2004 in respect of 2003 to holders of ordinary shares and preference shares of Rouble 0.9186 [Y31]per ordinary share (2003 – Rouble 0.7066 [Y32]per ordinary share) and Rouble 2.4510 [Y33]per preference share (2003 –Rouble 1.7954 [Y34]per preference share).

In accordance with the Russian legislation, dividends may only be declared to the shareholders of the Company from net income as shown in the Company's Russian statutory financial statements. The Company reported net income of 2,056,268 [Y35]and 2,001,256 [Y36]in its statutory financial statements in 2004 and 2003, respectively.

The Company's shareholding structure as of December 31, 2004 was as follows:

	Ordinary shares		**Preference shares**		
	Number (thousands)	**%**	**Number (thousands)**	**%**	**Total**
OJSC "Svyazinvest"	124,634	50.67	–	–	124,634
Other legal entities	71,523	29.08	56,116	68.45	127,639
ADR Holders	35,316	14.36	–	–	35,316
Individuals	14,497	5.89	25,867	31.55	40,364
Total	**245,970**	**100**	**81,983**	**100**	**327,953**

18. Minority Interest

The movements of minority interest for the years ended December 31, 2004 and 2003 were as follows:

	2004	**2003**
Minority interest as of January 1	**345,803**	464,504
Minority interest in subsidiaries acquired	**3,113**	150,124
Dividends paid to minority shareholders	**(4,874)**	(2,758)
Acquisition of minority interests	**(28,011)**	(367,008)
Minority interests in current year income	**93,063**	111,267
Minority interest in subsidiaries disposed	**(31,881)**	(10,326)
Minority interest as of December 31	**377,213**	345,803

(in thousands rubles)

19. Borrowings

As of December 31, 2004 and 2003 borrowings comprised the following:

	Interest rate	Maturity date	2004	2003
Short-term borrowings				
Bank loans:				
Bank loans (Roubles)	10-13.5%	2005	**2,522,522**	811,502
Bank loans (US Dollars)	5%	2005	**25,734**	17,726
Bank loans (Euro)	9%	2005	**168,743**	191,239
Total bank loans			**2,716,999**	1,020,467
Accrued interest on bonds (Roubles)		2005	**57,328[Y37]**	80,777
Vendor financing				
Vendor financing (Roubles)	6-11%	2005	**1,704**	–
Vendor financing (US Dollars)	6.5-8%	2005	**66**	30,408
Vendor financing (Euro)	6.8-7.35%	2005	**21,455**	92,308
Vendor financing (Japanese yen)	5.91%	2005	**3,755**	2,696
Total vendor financing			**26,980**	125,412
Promissory notes (Roubles)	13%	2005	–	413,712
Total short-term borrowings			**2,801,307**	1,640,368
Long-term borrowings				
Bank loans:				
Bank loans (Roubles)	7-14%	2005-2009	**3,578,169**	1,314,093
Bank loans (Euro)	6.5-9%	2005-2007	**178,586**	355,397
Total bank loans			**3,756,755**	1,669,490
Bonds (Roubles)	13.67%	2006	**1,000,000**	1,000,000
Vendor financing:				
Vendor financing (Roubles)	6-11%	2005-2006	**260,206**	52,112
Vendor financing (US Dollars)	6.5-8%	2005-2007	**105,707**	172,058
Vendor financing (Euro)	6.8-7.35%	2005-2006	**251,152**	206,334
Total vendor financing			**617,065**	430,504
Promissory notes (Roubles)	6%	2005-2006	**699,230 [TT38]**	–
Less: Current portion of long-term borrowings			**(1,816,704)**	(604,320)
Total long-term borrowings			**4,256,346**	2,495,674

As of December 31, 2004 short-term borrowings included interest payable in the amount of 171,477 [Y39](2003 – 182,697).

As of December 31, 2004 bank loans are secured by property, plant and equipment with the carrying value of approximately 8,918,000 (2003 – 5,361,000).[Y40]

(in thousands rubles)

19. Borrowings (continued)

As of December 31, 2004, long-term borrowings had the following maturity schedule:

Maturity date	Bank loans	Bonds	Vendor financing	Promissory notes	Total
2005	910,525	–	447,414	458,765	1,816,704
2006	269,116	1,000,000	165,980	240,465	1,675,561
2007	388,114	–	3,671	–	391,785
2008	709,000	–	–	–	709,000
2009	1,480,000	–	–	–	1,480,000
Total	**3,756,755**	**1,000,000**	**617,065**	**699,230**	**6,073,050**

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

Currency	2004	2003
Russian Roubles	**7,679,017**	3,672,196
US dollars	**571,651**	220,192
Euro	**619,935**	845,278
Japanese yen	**3,754**	2,696
Total	**8,874,357**	4,740,362

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

Short-term Loans

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.

Sberbank

Short-term borrowings from Sberbank mostly represent rouble denominated loans received in 2003 - 2004. The agreements terminate in 2005. The loans attract interest at 10-13.5%. As of December 31, 2004, the outstanding amount was 889,886[Y41]. The loans are collateralized with property, plant and equipment valued at 1,389,783[Y42]

International Moscow Bank

In November 2003, the Company entered into a loan agreement with International Moscow Bank. The total amount of 500,623 [Y43]was outstanding as of December 31, 2004. Interest is accrued at 11.25 - 12[Y44]% per annum. The loan matures in February 2005. The loan is collateralized with property, plant and equipment valued at 2,253,578[Y45].

19. Borrowings (continued)

Short-term Loans (continued)

Bank Loans (continued)

Borskiy Commercial Bank

In October 2004, the Company entered into a loan agreement with LLC Borskiy Commercial Bank. The total amount of 15,000 [Y46]was outstanding as of December 31, 2004. Interest is accrued at 13[Y47]% per annum. The loan matures in October 2005. The loan is collateralized with property, plant valued at 31,845[Y48].

Vneshtorbank

The Company's short-term borrowings from OJSC "Vneshtorgbank" are represented by promissory notes loans signed in 2004. Amount outstanding as of December 31, 2004 is 900,000[Y49]. Loans terminate in 2005. Discount on these notes ranged from 10 to 11[Y50]%. The loans are not secured.

Sarovbusinessbank

The Company's short-term borrowings from OJSC "Sarovbusinessbank" are represented by promissory notes loan repayable in 2005. Amount outstanding as of December 31, 2004 is 200,000[Y51]. The loan attracts interest at 10[Y52]% per annum. The loan is not secured.

Vendor Financing

Alkatel

In 2001-2004 the Company entered into several agreements with Alkatel under which Alcatel delivered and installed telecommunication equipment. The related liability is denominated in Euro and US dollar. Part of these loans bears interest at 3.5-6 % per annum. Non-interest bearing loans as at December 31, 2004 were reported at the present value of future payments under the agreements using a discount factor of 6.8%, which approximates a weighted average interest rate on the Company's interest bearing borrowings obtained in appropriate periods and denominated in Euro. The amount outstanding as of December 31, 2004 is 11,478[Y53].

IskraTel

In 2001-2002 the Company entered into agreements with IskraTel in the total amount of 3,057 thousand Euro. The agreements are non-interest bearing. The liability as of December 31, 2004 was reported at the present value of the future payments under the agreements using a discount factor of 7%, which approximates a weighted average interest rate on the Company's interest bearing borrowings obtained in appropriate periods. The amount outstanding as of December 31, 2004 is 16,389[Y54].

19. Borrowings (continued)

Short-term Loans (continued)

Vendor Financing (continued)

Huawei

In 2001-2004 the Company entered into several agreements with Huawei in the total amount of 11,783 thousand US dollar. These agreements are non-interest bearing. The agreements do not provide for interest payments thus the amount of liability as at December 31, 2004 was reported at the present value of future payments under the agreements using a discount factor of 6.5% which approximates a weighted average interest rate on the Company’s interest bearing borrowings obtained in appropriate periods. The amount outstanding as of December 31, 2004 is 9,789[Y55].

NPO ATS

In 2004 the Company entered into two agreements with NPO ATS denominated in USD for delivery of telecommunication equipment. The agreements do not provide for interest payments thus the amount of liability as at December 31, 2004 was reported at the present value of future payments using a discount factor of 6.5%, which approximates a weighted average interest rate on the Company’s interest bearing borrowings obtained in appropriate periods. The amount outstanding as of December 31, 2004 is 19,948[Y56].

Long-term Borrowings

Bank Loans

Sberbank

Long-term borrowings from Sberbank mostly represent rouble denominated loans received in 2003-2004. The agreements terminate on 2006-2008. The loans attract interest at 12-13.5%. As of December 31, 2004, the outstanding amount was 3,231,018[Y57]. The loans are secured with property, plant and equipment valued at 6,194,611[Y58].

Vnesheconombank

In 1995-1996, the Ministry of Finance of the Russian Federation (hereinafter, “the Ministry”) 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. Liabilities are denominated in Euro. As of December 31, 2004, the outstanding amount was 310,335[TT59], including 112,274 of current portion and 168,291 of interest. The interest under these agreements is accrued at floating rate Plafond C, which in 2004 approximated 6.50 %, plus 2 % per annum. The loan is not secured.

AK Bars

In October 2003 the Company entered into a loan agreement with OJSC “AK Bars” totalling to 185,000. The loan attracts interest at 14% per annum. As of December 31, 2004, the outstanding amount was 124,958. This agreement terminates on October 2006. The loan is secured with property, plant and equipment valued at 421,164.

19. Borrowings (continued)

Long-term Borrowings (continued)

Bank Loans (continued)

International Moscow Bank

In August 2004, the Company entered into a loan agreement with International Moscow Bank. The total amount of 39,508 was outstanding as of December 31, 2004. The loan attracts interest at 13.5% per annum. The loan matures in August 2006. The loan is secured with property, plant and equipment valued at 81,250.

Promissory Notes

Amdocs Billing Suite software was supplied in December 2004 by IBM Eastern Europe/Asia, in exchange for which the Company issued dollar denominated promissory notes in the amount of 721,394 of which 480,929 is due in 2005 and 240,465 is repayable in 2006.

Bonds

On February 2003, the Company registered the issue of 1,000,000 interest-bearing bonds, series VT-1, par value of 1,000 Roubles each. The bonds have 12 quarterly coupons. Coupon interest rate is set at 13.67% per annum. The bonds mature in 1,096 days from the date of issue.

The bonds provided put option which terminated on February 24, 2004. The bonds holders did not require the Company to redeem the bonds.

Vendor Financing

Alkatel

The Company's long-term liabilities to Alcatel Sel AG are represented by the amounts payable for the telecommunication equipment under contracts signed in 2004 and totalling to 267,621. The amounts payable under these agreements are denominated in Euro. The agreements bears an interest rate of 3.5%. Equipment received under these agreements is pledged to the supplier until the final payment is made.

Siemens AG

In 1997-2001 the Company entered into several agreements with Siemens AG totalling to 5,460 thousand Euro, under which Siemens AG delivered telecommunication equipment to the Company. The amounts payable under these agreements are denominated in Euro. The loans under the agreements attract interest at 6% per annum. Amount outstanding as of December 31, 2004 is 19,081.

(in thousands rubles)

19. Borrowings (continued)

Long-term Borrowings (continued)

Vendor Financing (continued)

BETO-Huawei

In 2004 the Company entered into several agreements with Beto-Huawei denominated in USD, under which it delivered telecommunication equipment to the Company. This agreement doesn't provide for interest payments thus the amount of liability as at December 31, 2004 was reported at the present value of future payments using a discount factor of 6.5%, which approximates a weighted average interest rate on the Company's interest bearing borrowings obtained in appropriate periods. The amount outstanding as of December 31, 2004 was 141,259.

Metrosvyaz Limited

In April 1999 the Company entered into agreement with Metrosvyaz Limited totalling 3,370,000 USD under which Metrosvyaz Limited delivered telecommunication equipment to the Company. This agreement doesn't provide for interest payments thus the amount of liability as at December 31, 2004 was reported at the present value of future payments using a discount factor of 11%, which approximates a weighted average interest rate on the Company's interest bearing borrowings obtained in appropriate periods. The amount outstanding as of December 31, 2004 was 99,262.

20. Finance Lease Obligations

The Company has finance lease contracts for telecommunication equipment. Future minimum lease payments under finance lease contracts together with the present value of the net minimum lease payments as of December 31, 2004 and 2003 are as follows:

	2004		**2003**	
	Minimum lease payments	**Present value of payments**	**Minimum lease payments**	**Present value of payments**
Current portion	**531,944**	**345,720**	510,111	321,109
2 to 5 years	**934,075**	**698,769**	717,399	520,394
Total minimum lease payments	**1,466,019**	**1,044,489**	1,227,510	841,503
Less amounts representing finance charges	**(421,530)**	–	(386,007)	–
Present value of minimum lease payments	**1,044,489**	**1,044,489**	841,503	841,503

(in thousands rubles)

20. Finance Lease Obligations (continued)

In 2004 and 2003, the Company’s primary lessors were OJSC RTC-Leasing and LLC Promsvyazleasing. In 2004, the effective interest rate on lease liabilities ranged from 17.5[TT60]% to 39[TT61]% per annum (2003 - from 21% to 39%[Y62]).

OJSC RTC-Leasing purchases telecommunication equipment from domestic and foreign suppliers and provides such equipment to the Company under finance lease agreements. The Company’s obligations under finance leases to OJSC RTC-Leasing as of December 31, 2004 amounted to 929,232 (2003 – 622,444). [TT63]

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, 2004 finance lease obligations denominated in foreign currency, mainly US dollars, amounted to 12,819 (2003 – 73,879[TT64]).

21. Accounts Payable, Accrued Expenses and Advances Received

As of December 31, 2004 and 2003, the Company’s accounts payable and other current liabilities comprised the following:

	2004	2003
Accounts payable for capital investments	**1,266,486**	831,568
Advances received from subscribers	**501,773**	455,021
Trade accounts payable	**358,955**	194,394
Salaries and wages	**366,046**	314,291
Accounts payable on acquisition of subsidiaries	–	184,042
Other accounts payable	**99,193**	166,300
Total	**2,592,453**	2,145,616

59,128 and 20,571 [TT65]included in trade payables as of December 31, 2004 and 2003, respectively, are denominated in foreign currency, mainly Euro.

22. Taxes Payable

As of December 31, 2004 and 2003, taxes payable comprised the following:

	2004	2003
Value-added tax	**565,540**	459,286
Profits tax	**114,098**	6,913
Property tax	**102,282**	44,763
Sales tax	**81**	41,339
Unified social tax	**45,789**	125,239
Other taxes	**17,260**	64,605
Total	**845,050**	742,145

22. Taxes Payable (continued)

Included in value added tax payable is the amount of 374,786[Y66] (2003 – 303,803[Y67]), which represents deferred value added tax, that is only payable to the tax authorities when the underlying receivables are recovered or written off.

23. Pension Obligations

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

Defined contribution pension plans

For employees of certain branches, the Company provides post-employment benefits, which are classified as defined contribution pension plans. Non-government pension fund Telecom-Soyuz, which is related to the Company, maintains the plan.

Defined Benefit Pension Plans

Most employees are covered by defined benefit pension plan. The defined benefit pension plan provides old age retirement pension and disability pension. The plans provide for payment of retirement benefits starting from statutory retirement age, which are 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.

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

The Company also provides several long-term employee benefits such as a death-in-service benefit and lump-sum payment 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.

During 2004 the Company made 99,296 of contributions under its defined contribution and defined benefit pension plans (2003 – 74,153) that were expensed.

(in thousands rubles)

24. Revenues

Revenue for the year ended December 31, 2004 and 2003 comprised the following:

By revenue types	2004	2003
Long distance telephone services – domestic	**6,189,303**	4,953,061
Long distance telephone services – international	**821,065**	764,346
Local telephone calls	**5,493,216**	4,267,093
Installation and connection fees	**1,487,088**	1,422,122
Documentary services	**60,778**	51,292
Cellular services	**2,723,029**	2,090,214
Radio and TV broadcasting	**508,474**	416,123
Data transfer and telematics services	**186,985**	177,574
New services	**759,419**	444,191
Rent of telephone channels	**280,632**	221,453
Revenues from national operators	**1,128,805**	746,352
Other telecommunications services	**670,883**	591,083
Other revenues	**656,866**	581,234
Total	**20,966,543**	16,726,138

The Company identifies revenue by the following major customer groups:

Customer groups	2004	2003
Residential customers	**11,289,593**	9,045,017
Corporate customers	**7,143,513**	5,609,109
Government customers	**1,567,158**	1,152,943
Tariff compensation from the state budget	**966,279**	919,069
Total	**20,966,543**	16,726,138

(in thousands rubles)

25. Other Operating Expenses, net

Other operating expenses, net for the year ended December 31, 2004 and 2003 comprised the following:

	2004	2003
Payments to Gossvyaznadzor	**(104,313)**	(56,311)
Fire and other security services	**(192,079)**	(146,085)
Business travel expenses and representation costs	**(54,737)**	(42,275)
Transportation services	**(29,550)**	(37,234)
Post services	**(11,570)**	(38,727)
Education expenses	**(43,725)**	(26,503)
Cost of goods sold	**(194,332)**	(256,300)
Rent of premises	**(179,934)**	(143,574)
Audit and consulting fees	**(84,432)**	(78,346)
Non-commercial partnership expenses (Note 33)	**(150,100)**	(135,804)
Advertising expenses	**(129,064)**	(105,775)
Insurance	**(85,048)**	(69,138)
Charitable contributions	**(81,994)**	(62,203)
Civil defence	**(26,822)**	(17,607)
Dealers commission fees	**(144,917)**	(82,517)
Bank services fees	**(47,574)**	(34,199)
Buildings maintenance	**(90,189)**	(55,364)
Auxiliary production services	**(30,243)**	(10,441)
Other expenses	**(329,521)**	(134,959)
Total	**(2,010,144)**	(1,533,362)

Other expenses include expenses related to research and advanced development, agent fees, fines and penalties, social expenditures, billing and cash collection from customers, cost of documentary, pay phone and other telecommunication services, representation expenses and other operating expenses.

26. Interest Expense, net

Interest expense, net for the year ended December 31, 2004 and 2003 comprised the following:

	2004	2003
Interest income	**9,825**	13,089
Interest expense	**(437,708)**	(266,282)
Interest expense accrued on finance leases	**(216,075)**	(145,318)
Total	**(643,958)**	(398,511)

(in thousands rubles)

27. Gain/ (Loss) from Sale of Subsidiaries, Associates and Other Investments

Gain/ (loss) from sale of subsidiaries, associates and other investments for the year ended December 31, 2004 and 2003 comprised the following:

	2004	2003
Gain (Loss) on sale of investments (see also Notes 7 and 8)	**80,989**	(17,866)
Other gain (loss) on investments	**1,169**	(34,613)
Dividend income	**5,986**	6,354
Total	**88,144**	(46,125)

28. Income Tax

Income tax charge for the years ended December 31, 2004 and 2003 comprised the following:

	2004	2003
Current income tax expense	**(1,145,707)**	(859,877)
Prior year income tax adjustments	**22,709**	(10,749)
Deferred income tax expense	**(44,259)**	(159,589)
Total income tax for the year	**(1,167,257)**	(1,030,215)

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

	2004	2003
Profit before income tax and minority interest	**3,739,317**	3,138,511
Statutory income tax rate	**24%**	24%
Theoretical tax charge at statutory income tax rate	**(897,436)**	(753,243)
Increase (decrease) resulting from the effect of:		
Prior-year income tax adjustments	**22,709**	(10,749)
Non-taxable income	**43,527**	34,224
Other permanent differences	**(336,057)**	(300,447)
Total income tax charge for the year at the effective rate of 31% (2003 - 33%)	**(1,167,257)**	(1,030,215)

(in thousands rubles)

28. Income Tax (continued)

The composition of deferred income tax assets and liabilities as of December 31, 2004 and 2003 was as follows:

	2004	2003
Deferred tax assets:		
Accounts payable and accrued expenses	**72,948**	26,289
Accounts receivable	**181,183**	91,267
Loans and borrowings	**100,216**	76,343
Finance lease	–	19,786
Deferred tax asset, total	**354,347**	213,685
Deferred tax liabilities:		
Property, plant and equipment	**(1,333,734)**	(1,107,375)
Inventory	**(8,677)**	(7,622)
Investment valuation effect	**(5,505)**	(55,694)
Finance lease	**(3,220)**	–
Deferred income tax liability, total	**(1,351,136)**	(1,170,691)
The above differences resulted in:		
Deferred tax asset	**24,814**	54,104
Deferred tax liability	**(1,021,603)**	(1,011,110)

The movement in deferred tax asset for the years ended December 31, 2004 and 2003 was as follows:

	2004	2003
Deferred tax asset, at January 1	**54,104**	1,088
Deferred tax income (expense)	**(29,290)**	(7,506)
Share in deferred income tax of acquired companies	–	60,522
Net deferred tax asset, at December 31	**24,814**	54,104

The movement in net deferred tax liability for the years ended December 31, 2004 and 2003 was as follows:

	2004	2003
Deferred tax liability, net at January 1	**(1,011,110)**	(859,027)
Deferred tax income (expense)	**(14,969)**	(152,083)
Share in deferred income tax of acquired companies	–	–
Deferred tax liabilities of subsidiaries disposed	**4,476**	–
Net deferred tax asset (liability) at December 31	**(1,021,603)**	(1,011,110)

(in thousands rubles)

29. Earnings per Share

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

	2004	2003
Weighted average number of preference shares outstanding (thousands)	**81,983**	81,983
Weighted average number of ordinary shares outstanding (thousands)	**245,970**	245,970
Weighted average number of ordinary and preference shares outstanding (thousands)	**327,953**	327,953
Net profit	**2,478,997**	1,997,029
Earning per share, (basic/diluted)	**7.56**	6.09

There are no dilutive instruments. Accordingly basic earnings per share equal the diluted earnings per share.

30. Dividends Declared and Proposed for Distribution

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

Dividends declared and approved during the year:

	2004	2003
Dividends on ordinary shares – 0.9186 Roubles per share (for 2003 – 0.7066 Roubles per share)	**225,948**	173,802
Dividends on preference shares – 2.4510 Roubles per share (for 2003 – 1.7954 Roubles per share)	**200,941**	147,193
Total	**426,889**	320,995

Dividends declared and approved subsequent to December 31, 2004 (See Note 35 “Subsequent events”):

Dividends on ordinary shares – 1.3779 Roubles per share	338,921
Dividends on preference shares – 2.5082 Roubles per share	205,631
Total	**544,552**

31. Contingencies and Operating Risks

Operating Environment of the Company

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

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.

Taxation

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

As of December 31, 2004 management believes that its interpretation of the relevant legislation is appropriate and that it is probable that the Company’s tax, currency and customs positions will be sustained. The Company intends to defend its position on these issues. As at December 31, 2004 the financial statements do not contain adjustments which may become necessary because of these uncertainties and positions assumed by the Company.

In February 2005 tax authorities raised significant claim against one of the companies of OJSC “Svyazinvest” Group, as a result of tax examination of the company’s operations for the years 2002-2003.

The Company does not expect similar claims since aforementioned company disagreed with the claim raised by tax authorities, brought the case before the court to contest tax authorities’ claim, and estimated the probability of winning the claim as high. Additionally, the tax authorities carried out examination in other companies of the OJSC “Svyazinvest” Group for the same periods, and claims raised against them were insignificant.

31. Contingencies and Operating Risks (continued)

Insurance Coverage

During 2004, 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

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

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

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 July 12, 2005 in the amount of 228,972 (6,637 thousand euro).

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.

Licenses

Substantially all of the Company's revenues are derived from operations conducted pursuant to licenses granted by the Russian Government. These licenses expire in various years ranging from 2005 to 2012. The Company has 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. 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.

Guarantees Issued

The Company guaranteed credit line facilities provided by Sberbank to OJSC "RTC-Leasing", a lessor of telecommunication equipment, as of December 31, 2004 (Note 20). The guarantees amounted to 1,308,567 (2003 – 1,236,657).

32. Commitments

Capital Investments

As of December 31, 2004 the Company has commitments of 109,794 [TT68] for capital investments into modernization and expansion of its network.

33. Balances and Transactions with Related Parties

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

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

The nature of the related party relationships for those related parties with whom the Company entered into significant transactions or had significant balances outstanding at December 31, 2004 are detailed below.

Transactions with Government Organizations

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

Government subscribers accounted for approximately 51%[Y69] of gross trade accounts receivable as of December 31, 2004 (2003 – 41%). Amounts outstanding from government subscribers, including debt of social security organizations with regard to compensation of expenses related to granting privileges to certain category of subscribers, as of December 31, 2004 amounted to 1,242,742 (2003 – 745,511) (see Note 12).

OJSC Svyazinvest

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

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

(in thousands rubles)

33. Balances and Transactions with Related Parties (continued)

OJSC Svyazinvest (continued)

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

In 2003 the Company repaid two loans to OJSC “Svyazinvest” in amount of 62,526. The Company did not receive or repaid any loans from its parent entity during 2004.

OJSC Rostelecom

OJSC “Rostelecom”, a majority owned subsidiary of OJSC “Svyazinvest”, is the primary provider of domestic long distance and international telecommunications services in the Russian Federation. The annual expense associated with traffic carried by OJSC “Rostelecom” and terminated outside of the Company’s network is stated as interconnection charges. Further, OJSC “Rostelecom” uses the Company’s network to provide incoming long-distance and international traffic to its subscribers and partner operators.

Transactions undertaken by the Company with OJSC “Rostelecom” reported in the accompanying consolidated financial statements as at December 31, 2004 and 2003 and for the years then ended are presented in the following tables.

Sale of Services

During the year ended December 31, 2004 and 2003 the Company rendered significant amount of services to the following related parties:

Related party	Relationship	Type of sales	Price determination method	2004	2003
OJSC Rostelecom	Controlled by OJSC Svyazinvest	Telecommunication service	Regulated tariff	**790,363**	192,091
CJSC Rostelegraph	Controlled by OJSC Svyazinvest	Telecommunication service	Regulated tariff	**51,470**	–
CJSC Samara Telecom	Associate company	Telecommunication services, rent of premises	Arms' length terms	**33,375**	27,255
CJSC Sotel-NN	Associate company	Telecommunication services, rent of premises	Arms' length terms	**6,178**	3,455
CJSC Tsifrovye seti Udmurtii - 900	Associate company	Telecommunication services, rent of premises	Arms' length terms	**5,864**	11,254
CJSC Nizhegorodsky Radiotelephone	Associate company	Telecommunication services, transportation services	Arms' length terms	**4,406**	2,035
CJSC Chuvashia Mobile	Associate company	Telecommunication services, rent of premises	Arms' length terms	**4,168**	2,681

(in thousands rubles)

33. Balances and Transactions with Related Parties (continued)

Purchases

During the year ended December 31, 2004 and 2003 the following related parties rendered significant amount of services to the Company:

Related party	Relationship	Type of sales	Price determination method	2004	2003
CJSC Transsvyaz	Associate company	Construction works	Arms' length terms	**1,265**	5,889
CJSC Samara Telecom	Associate company	Telecommunication services, rent of premises	Arms' length terms	**6,474**	683
OJSC Rostelecom	Controlled by OJSC Svyazinvest	Telecommunication services	Regulated tariff	**1,905,386**	1,377,380
CJSC Rostelegraph	Controlled by OJSC Svyazinvest	Telecommunication services	Regulated tariff	**48,830**	–

Balances with Related Parties

As of December 31, 2004 and 2003 significant balances with related parties were as follows:

Accounts receivable:

Related party	Relationship	Type of receivables	2004	2003
CJSC Samara Telecom	Associate company	Telecommunication services	**7,005**	1,218
CJSC Sotel-NN	Associate company	Telecommunication services, repair services, transportation services	**5,438**	787
CJSC Nizhegorodsky Radiotelephone	Associate company	Rent and transportation services	**4,507**	731
CJSC Rostelegraph	Controlled by OJSC Svyazinvest	Telecommunication services	**2,953**	–
CJSC Chuvashia Mobile	Associate company	Telecommunication services, rent and transportation services	**1,549**	55
CJSC Rusleasingsvyaz	Controlled by OJSC Svyazinvest	Finance lease	**1,485**	–
CJSC Tsifrovye seti Udmurtii - 900	Associate company	Telecommunication services, other services	**792**	1,213

Accounts payable:

Related party	Relationship	Type of receivables	2004	2003
OJSC Rostelecom	Controlled by OJSC Svyazinvest	Telecommunication services	**110,965**	47,144
CJSC Rusleasingsvyaz	Controlled by OJSC Svyazinvest	Finance lease	**1,921**	1,656
CJSC Rostelegraph	Controlled by OJSC Svyazinvest	Telecommunication services	**1,848**	–

33. Balances and Transactions with Related Parties (continued)

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 OJSC Svyazinvest controls through its subsidiaries. The Company has an agreement with the Partnership, under which it provides funding for industry research and common administrative activities on behalf of the Company and other subsidiary and associates of OJSC “Svyazinvest”. Payments to the Partnership included in other operating expenses in the accompanying consolidated statement of operations for the year ended December 31, 2004 amounted to 150,100 (2003 – 135,804).

NPF Telecom-Soyuz

The Company has a number of pension agreements with NPF Telecom-Soyuz (see Note 23 “Pension Plans and Employee Benefits”). OJSC “Svyazinvest” holds the majority in the Board of Directors of NPF Telecom-Soyuz (“the Fund”). Payments from the Company to the Fund in 2004 amounted to 69,914 [TT70](2003 – 68,686).

Compensation to Key Management Personnel

Key management personnel comprise members of the Management Board and the Board of Directors of the Company, totalling 27 and 23 persons as of December 31, 2004 and 2003, respectively. Total compensation to key management personnel included in “Wages, salaries, other employee benefits and payroll taxes” in the statement of operations amounted to approximately 64,000 and 27,000 for the years ended December 31, 2004 and 2003, respectively.

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

34. Financial Instruments

Fair Value

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

Management believes that the carrying values of monetary assets and liabilities approximate their fair values. Balance sheet items denominated in foreign currency have been translated into Roubles using the corresponding exchange rate prevailing at the reporting date.

Carrying value of cash and cash equivalents approximate their fair value due to their short-term character and minimal credit risks.

34. Financial Instruments (continued)

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 state and other non-commercial organizations. Recovery of this debt is influenced by political and economic factors, however, management believes that as of December 31, 2004 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.

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 19, 20 and 21) give rise to foreign exchange exposure.

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

For the period from January 1, 2003 to December 31, 2004 exchange rate of the Russian Ruble to US Dollar increased by approximately 13% and exchange rate of the Russian Ruble to Euro decreased by approximately 14%. Possible decrease in the exchange rate of the Russian Ruble will lead to an increase in the amount of the Company’s borrowings, as well as will cause difficulties in attraction of funds including funds required for refinancing of 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.

(in thousands rubles)

34. Financial Instruments (continued)

Interest Rate Risk (continued)

The following table presents as of December 31, 2004 and 2003 the carrying amount by maturity of the Company’s financial instruments that are exposed to interest rate risk:

As of December 31, 2003:	**< 1 year**	**1-5 years**	**> 5 years**	**Total**
Fixed rate				
Short-term obligations	1,498,821	–	–	1,498,821
Long-term obligations	461,486	2,375,407	42,688	2,879,581
Finance lease obligations	321,109	520,394	–	841,503
Floating rate				
Short-term obligations	141,547	–	–	141,547
Long-term obligations	142,834	77,579	–	220,413

As of December 31, 2004:	**< 1 year**	**1–5 years**	**> 5 years**	**Total**
Fixed rate				
Short-term obligations	**2,601,606**	**–**	**–**	**2,601,606**
Long-term obligations	**1,704,430**	**3,206,288**	**20,288**	**4,931,006**
Finance lease obligations	**345,720**	**698,769**	**–**	**1,044,489**
Floating rate				
Short-term obligations	**199,701**	**–**	**–**	**199,701**
Long-term obligations	**112,274**	**1,029,770**	**–**	**1,142,044**

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.

35. Subsequent Events

Sale of investments

In March 2005 the Company sold its 16.9% share in CJSC “Samarasvyazinform” to a private individual for 21,773.

In March 2005 the Company disposed of its 32.4% share in OJSC “Telesot” for 14,404.

Purchase of CJSC “RTCOM”

On March 9, 2005 in accordance with the decision of the Board of Directors dated December 22, 2004 the Company acquired 100% stake in CJSC “RTCOM” (8,248 ordinary shares) for 10,000. The subsidiary was purchased for the purpose of rendering cellular services in Mordovia region as part of the Company’s mobile business development program.

35. Subsequent Events (continued)

Purchase of share in OJSC “Svyazintek”

In accordance with the resolution of the extraordinary meeting of the Company’s shareholders held on February 14, 2005 the Company acquired 13% of shares in OJSC “Svyazintek” for 19.5.

OJSC “Svyazintek” was established in 2005 for implementation of Amdocs billing software in the companies of OJSC “Svyazinvest” Group.

Purchase of LLC “Nizhegorodsky teleservice”

In July 2005 the Company acquired 100% stake in LLC “Nizhegorodsky teleservice” from LLC “Invekt” for 43,728. The purchase was approved by the Board of Directors in May 2005. The subsidiary provides data transmission and telematics services.

Loan agreements

During January-June 2005 the Company obtained new bank loans and issued promissory notes in total amount of 3,518,747 and repaid bank loans and promissory notes in amount of 2,584,978. New loans attract interest at 10-13.5% per annum.

Dividends

On June 28, 2005 the general meeting of the Company's shareholders approved dividends for 2004 in the amount of 2.5082 roubles per preference share and 1.3779 roubles per ordinary share. Total dividends declared amounted to 205,631 and 338,921 for preference and ordinary shares, respectively. Dividends for the year ended December 31, 2004, are payable during 2005 and will be accrued in the financial statements for the year ended December 31, 2005 (see also Note 30 “Dividends Declared and Proposed for Distribution”).

Telecommunication Reform

In 2005, within the framework of government efforts to restructure the telecommunication industry (liberalization of the telecommunication market) the Company will be providing domestic and international long-distance communication services on the basis of restructured relations with OJSC Rostelecom. These relations will be regulated by an agreement to assist in provision of domestic and international long-distance communication services and an agreement on interconnection to telecommunications lines.

Under the assistance agreement, the Company will provide access to domestic and international long-distance communication services of OJSC "Rotelecom", keep records and rating of provided services and receive payments for them, and also claim accounts receivable. The Company's revenue under the assistance agreement will be formed by fees paid by OJSC Rostelecom.

Under the interconnection agreement, the Company will provide to OJSC Rostelecom traffic transmission services (call initiation and completion, traffic transit to/from interconnected operator networks).

The Company expects that the modified interaction framework will result in a decrease in both revenue and expenses, but the profit will remain at the previous level.

35. Subsequent Events (continued)

Unified Social Tax

Federal Law No. 70-FZ dated July 20, 2004 amended article 24 of the Tax Code of the Russian Federation stipulates the reduction of unified social tax rate effective from January 1, 2005.

The reduction of the unified social tax rate from 35.6% to 26% will lead to a decrease in the amount of the unified social tax, a decrease in operating expenses, and an increase in net profit of the Company.