Open Joint Stock Company
"VolgaTelecom"

Consolidated Financial Statements

For the year ended December 31, 2006
with Independent Auditor's Report

OJSC "VolgaTelecom"

Consolidated Financial Statements

For the year ended December 31, 2006

Contents

ERNST & YOUNG

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Independent Auditors' Report

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

We have audited the accompanying consolidated financial statements of Open Joint Stock Company "VolgaTelecom" and its subsidiaries (hereinafter "the Company"), which comprise the consolidated balance sheet as at 31 December 2006, and the consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. Except for the matter described in the Basis for Qualified Opinion, we conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

ERNST & YOUNG

Basis for Qualified Opinion

As described in Note 2 "Basis of Presentation of the Financial Statements" and Note 6 "Property, Plant and Equipment", the Company transitioned to International Financial Reporting Standards (IFRS) at January 1, 2003 and applied an exemption in IFRS 1, "First-time Adoption of International Financial Reporting Standards", which permits to measure property, plant and equipment at the date of transition to IFRS at fair value and use that fair value as deemed cost. However, we were not able to satisfy ourselves as to whether the carrying amounts of property, plant and equipment as at January 1, 2003 were representative of fair value. Accordingly, we were unable to determine whether the carrying value of property, plant and equipment as of December 31, 2006 and 2005 complies with the requirements of IFRS. Further, we were unable to satisfy ourselves as to the related (i) depreciation expense for the years then ended and (ii) the deferred tax balances as of December 31, 2006 and 2005 and deferred tax expense for the years then ended.

Qualified Opinion

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to satisfy ourselves as to the matter described in the Basis for Qualified Opinion paragraph, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2006, its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Ernst & Young LLC

May 31, 2007

OJSC "VolgaTelecom"

Consolidated Balance Sheet

As of December 31, 2006

(in thousands roubles)

	Notes	2006	2005 restated
ASSETS			
Non-current assets			
Property, plant and equipment	6	**31,332,348**	28,525,610
Intangible assets and goodwill	7	**4,454,189**	2,745,615
Investments in associates	9	**129,103**	119,980
Long-term investments	10	**28,226**	24,910
Long-term accounts receivable and other financial assets	11	**35,062**	39,931
Long-term advances given	12	**517,655**	749,055
Deferred income tax asset	28	**16,476**	27,049
Total non-current assets		**36,513,059**	32,232,150
Current assets			
Inventories	13	**535,925**	544,087
Accounts receivable	14	**1,872,300**	1,296,011
Current income tax asset		**343,276**	38,813
Other current assets	15	**1,099,296**	1,519,748
Cash and cash equivalents	16	**461,417**	1,338,713
Total current assets		**4,312,214**	4,737,372
TOTAL ASSETS		**40,825,273**	36,969,522
EQUITY AND LIABILITIES			
Equity attributable to equity holders of the parent			
Share capital	18	**3,853,690**	3,853,690
Unrealised gain on available-for-sale investments		**5,434**	2,134
Retained earnings		**15,810,202**	14,228,313
Total equity attributable to equity holders of the parent		**19,669,326**	18,084,137
Minority interest		**473,302**	415,614
Total equity		**20,142,628**	18,499,751
Non-current liabilities			
Long-term borrowings	19	**9,497,836**	7,589,666
Long-term finance lease obligations	20	**596,516**	727,768
Pension Liabilities	23	**1,287,295**	1,106,204
Deferred revenue		**316,030**	331,618
Deferred income tax liability	28	**1,444,233**	1,336,072
Total non-current liabilities		**13,141,910**	11,091,328
Current liabilities			
Accounts payable, accrued expenses and advances received	21	**3,970,717**	2,574,536
Payables to Rostelecom		**96,307**	108,100
Income tax payable		–	76,541
Other taxes payable	22	**321,999**	812,712
Dividends payable		**64,672**	63,641
Short-term borrowings	19	**1,582,707**	683,741
Current portion of long-term borrowings	19	**707,181**	2,699,872
Current portion of long-term finance lease obligations	20	**797,152**	359,300
Total current liabilities		**7,540,735**	7,378,443
Total liabilities		**20,682,645**	18,469,771
TOTAL EQUITY AND LIABILITIES		**40,825,273**	36,969,522

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

OJSC "VolgaTelecom"

Consolidated Statement of Operations

For the year ended December 31, 2006

(in thousands roubles, except per share amounts)

	Notes	2006	2005 restated
Revenues	24	**24,848,703**	23,756,233
Wages, salaries, other benefits and payroll taxes		**(8,424,514)**	(7,954,563)
Depreciation and amortization	6,7	**(4,453,961)**	(3,417,659)
Materials, repairs and maintenance, utilities		**(2,658,736)**	(2,185,768)
Taxes other than income tax		**(624,204)**	(550,307)
Interconnection charges		**(2,220,734)**	(2,634,267)
Recovery (provision) for impairment of receivables	14	**320,540**	(12,020)
Gain/(loss) on disposal of property, plant, and equipment		**2,308**	(103,699)
Other operating expenses, net	25	**(2,513,437)**	(2,274,446)
Operating profit		**4,275,964**	4,623,504
Share of result of associates, net	9	**11,912**	20,713
Interest expense, net	26	**(1,020,783)**	(843,532)
Gain/(loss) on sale of subsidiaries, associates and other investments	27	**(48,371)**	41,842
Foreign exchange gain, net		**22,633**	53,118
Profit before income tax		**3,241,355**	3,895,645
Income tax expense	28	**(1,106,921)**	(1,391,621)
Profit for the year		**2,134,434**	2,504,024
Attributable to:			
Equity holders of the parent		**2,073,895**	2,465,295
Minority interests		**60,539**	38,729
		2,134,434	2,504,024
Earnings per share			
- basic and diluted, for profit for the year attributable to equity holders of the parent	29	**6.32**	7.52

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

OJSC "VolgaTelecom"

Consolidated Cash Flow Statement

For the year ended December 31, 2006

(in thousands roubles)

	Notes	2006	2005 restated
Cash flows from operating activities:			
Profit before income tax		**3,241,355**	3,895,645
Adjustments for:			
Depreciation and amortization	6, 7	**4,453,961**	3,417,659
(Gain) loss on disposal of property, plant and equipment		**(2,308)**	103,699
(Recovery) provision for impairment of receivables	14	**(320,540)**	12,020
Provision for obsolescence of inventory		**20,414**	2,874
Share of result of associates	9	**(11,912)**	(20,713)
(Gain) loss from sale of subsidiaries, associates and other investments	27	**48,371**	(41,842)
Interest expense, net	26	**1,020,783**	843,532
Foreign exchange (gain), net		**(22,633)**	(53,118)
Operating cash flows before working capital changes		**8,427,491**	8,159,756
Increase in accounts receivable		**(243,618)**	(162,113)
Decrease in other current assets		**441,868**	118,543
Decrease in inventories		**12,929**	315,812
Increase in accounts payable and accrued expenses		**792,532**	343,732
Increase (decrease) in taxes payable other than income tax		**(490,892)**	81,762
Increase in pension obligations		**181,091**	214,723
Cash flows generated from operations		**9,121,401**	9,072,215
Interest paid		**(1,086,653)**	(853,373)
Income tax paid		**(1,494,591)**	(1,113,867)
Net cash flows from operating activities		**6,540,157**	7,104,975
Cash flows from investing activities:			
Purchase of property, plant and equipment		**(5,024,487)**	(5,452,965)
Purchase of intangible assets		**(188,421)**	(459,114)
Purchase of Oracle E-Business Suite software		**(212,830)**	(140,973)
Purchase of Amdocs Billing software		**(217,265)**	(74,714)
Proceeds from sales of property, plant and equipment		**45,728**	117,211
Purchase of subsidiaries, net of cash acquired		**(651,764)**	(50,986)
Disposal of subsidiaries, net of cash disposed		–	3,383
Purchase of investments and other assets		**(47,000)**	(63,694)
Proceeds from disposal of investments and other financial assets		**210**	51,141
Interest received		**21,722**	22,942
Dividends received		**1,497**	1,528
Net cash flows used in investing activities		**(6,272,610)**	(6,046,241)
Cash flows from financing activities:			
Proceeds from borrowings		**5,624,807**	6,403,784
Repayment of borrowings		**(6,997,842)**	(9,240,037)
Proceeds from debt securities issued		**2,983,597**	5,259,438
Repayment of debt securities		**(1,008,388)**	(6,221)
Repayment of finance lease obligations		**(456,225)**	(777,703)
Repayment of vendor financing obligations		**(468,902)**	(772,286)
Repayment of promissory notes for Amdocs Billing Software		**(255,996)**	(498,528)
Repayment of other non-current liabilities		–	(927)
Dividends paid to equity holders of the parent		**(564,783)**	(509,398)
Dividends paid to minority		**(1,111)**	(328)
Net cash flows from financing activities		**(1,144,843)**	(142,206)
Net increase in cash and cash equivalents		**(877,296)**	916,528
Cash and cash equivalents at the beginning of the year		**1,338,713**	422,185
Cash and cash equivalents at the end of the year		**461,417**	1,338,713

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

OJSC "VolgaTelecom"

Consolidated Statement of Changes in Equity

For the year ended December 31, 2006

(in thousands roubles)

	Notes	Attributable to equity holders of the parent							Minority interests	Total equity
		Share capital								
		Preference shares	Ordinary shares	Retained earnings (before adjustment)	Correction of error	Retained earnings (restated)	Unrealized gain on available-for-sale investments	Total		
Balance at December 31, 2004	2	**963,366**	**2,890,324**	**12,489,617**	**(182,047)**	**12,307,570**	**800**	**16,162,060**	**377,213**	**16,539,273**
Profit for the year	2	–	–	2,562,060	(96,765)	2,465,295	–	2,465,295	38,729	2,504,024
Dividends to equity holders of parent		–	–	(544,552)	–	(544,552)	–	(544,552)	–	(544,552)
Unrealized gain on available-for-sale investments		–	–	–	–	–	1,334	1,334	–	1,334
Dividends of subsidiaries to minority shareholders		–	–	–	–	–	–	–	(87)	(87)
Disposal of minority interests due to disposal of subsidiaries		–	–	–	–	–	–	–	(241)	(241)
Balance at December 31, 2005	2	**963,366**	**2,890,324**	**14,507,125**	**(278,812)**	**14,228,313**	**2,134**	**18,084,137**	**415,614**	**18,499,751**
Profit for the year		–	–	2,073,895	–	2,073,895	–	2,073,895	60,539	2,134,434
Dividends to equity holders of parent	30	–	–	(588,792)	–	(588,792)	–	(588,792)	–	(588,792)
Unrealized gain on available-for-sale investments		–	–	–	–	–	3,300	3,300	–	3,300
Dividends of subsidiaries to minority shareholders		–	–	–	–	–	–	–	(1,111)	(1,111)
Acquisition of minority interests in existing subsidiaries	8	–	–	(325)	–	(325)	–	(325)	(1,740)	(2,065)
Adjustment to fair values of subsidiaries acquired related previously held interest (reclassification of associates to subsidiaries)		–	–	97,111	–	97,111	–	97,111	–	97,111
Balance at December 31, 2006		**963,366**	**2,890,324**	**16,089,014**	**(278,812)**	**15,810,202**	**5,434**	**19,669,326**	**473,302**	**20,142,628**

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”) for the year ended December 31, 2006 were authorized for issue by the General Director and the Chief Accountant of the Company on May 31, 2007.

The Company

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

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

The Company’s principal activity is providing telephone services (including local, intrazone calls), telegraph, data transmission services, rent of communication channels and wireless communication services on the territory of Povolzhie region of the Russian Federation.

Open joint-stock company Svyazinvest, controlled by the Russian Government, as a holding company, as of December 31, 2006 owned 51% of the Company’s ordinary voting stock.

Information on the Company’s main subsidiaries is disclosed in Note 8. All subsidiaries are incorporated under the laws of the Russian Federation.

Presentation of Financial Statements

The consolidated financial statements of OJSC “VolgaTelecom” are prepared based on standalone financial statements of the parent and its subsidiaries and associates prepared under unified accounting policy.

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

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

1. General Information (continued)

Liquidity and Financial Resources

As of December 31, 2006, the Company's current liabilities exceeded its current assets by 3,228,521 (December 31, 2005 – 2,641,071). As a result, there may be some doubts about the Company's ability to attract further financing and to pay its existing debts as they fall due.

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

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

Through 2007, the Company anticipates funding from a) cash generated from operations; b) financing from domestic and international lending institutions.

2. Basis of Presentation of the Financial Statements

Basis of Preparation

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

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

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

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

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

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

Basis of Preparation (continued)

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

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

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

Changes in Accounting Policies

The accounting policies adopted are consistent with those of the previous financial year except that the Company has adopted those new/revised standards and interpretations mandatory for financial years beginning on or after January 1, 2006.

The changes in accounting policies result from adoption of the following new or amended standards and interpretations:

- IFRS 6 “Exploration for and Evaluation of Mineral Resources”;
- IAS 19 (amended 2005) “Employee benefits”;
- IAS 21 (amended 2005) “The Effects of Changes in Foreign Exchange Rates”;
- IAS 39 (amended 2005) “Financial Instruments: Recognition and Measurement”
- IFRIC 4 “Determining whether an Arrangement contains a Lease”;
- IFRIC 5 “Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds”.

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

Changes in Accounting Policies (continued)

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

IAS 19 (amended 2005) "Employee benefits"

As of January 1st, 2006, the Company adopted the amendments to IAS 19. As a result, additional disclosures are made providing information about trends in the assets and liabilities in the defined benefit plans. This change has resulted in additional disclosures being included for the years ending December 31, 2006 and December 31, 2005 but has not had a recognition or measurement impact, as the Company chose not to apply the new option offered to recognize actuarial gains and losses outside of the income statement.

IAS 39 (amended 2005) "Financial Instruments: Recognition and Measurement"

The amendment to IAS 39 in 2005

- required to include financial guarantee contacts issued;
- permitted the foreign currency risk of a highly probable intra-Company forecast transaction to qualify as the hedged item in cash flow hedge, provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and that the foreign currency risk will affect the financial statements;
- restricted the use of the option to designate any financial asset or any financial liability to be measured at fair value through profit and loss.

IFRIC 4 "Determining whether an Arrangement contains a Lease"

IFRIC 4 provides guidance for determining whether arrangements are, or contain, leases that should be accounted for in accordance with IAS 17, if the arrangements comprise a transaction or a series of related transactions, that does not take the legal form of a lease but conveys a right to use an asset in return for a payment or series of payments. The adoption of this IFRIC Interpretation as of 1 January 2006 has not had a significant impact on the Company as at December 31, 2006 or December 31, 2005.

Other Standards and Interpretations mentioned did not have impact on the Company's financial statements.

IFRSs and IFRIC Interpretations not Yet Effective

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

- IFRS 7 "Financial Instruments: Disclosures";
- IAS 1 (amended 2005) "Presentation of Financial Statements – Capital Disclosures";
- IFRIC 8 "Scope of IFRS 2";
- IFRIC 9 "Reassessment of Embedded Derivatives";
- IFRIC 10 "Interim Financial Reporting and Impairment";
- IFRIC 11 "IFRS 2 - Company and Treasury Share Transactions".

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

IFRSs and IFRIC Interpretations not Yet Effective (continued)

IFRS 7 "Financial Instruments: Disclosures" replaces the disclosure requirements of IAS 32 and must be applied for annual reporting periods that commence on or after January 1, 2007.

The amendment of IAS 1 "Presentation of Financial Statements – Capital Disclosures" requires disclosures regarding an entity's objectives, policies and processes for managing capital. The provisions are effective for reporting periods beginning on or after January 1, 2007.

IFRIC 8 clarifies that IFRS 2 applies to arrangements where an entity makes share-based payments for apparently nil or inadequate consideration. If the identifiable consideration given appears to be less than the fair value of the equity instrument granted, under IFRIC 8 this situation typically indicates that other consideration has been or will be received. IFRS 2 therefore applies. IFRIC 8 becomes effective for financial years beginning on or after May 1, 2006.

IFRIC 9 clarifies, that an entity shall assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative when the entity first becomes a party to the contract. Subsequent reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract, in which case reassessment is required. An entity shall apply this interpretation for annual periods beginning on or after June 1, 2006.

Applying IFRIC 10, an entity shall not reverse an impairment loss recognized in a previous interim period in respect of goodwill or an investment in either an equity instrument or a financial asset carried at cost. An entity shall apply this interpretation for annual periods beginning on or after November 1, 2006.

IFRIC 11 addresses the issues whether the certain transactions should be accounted for as equity-settled or as cash-settled under the requirements of IFRS 2, and concerns the accounting treatment for share-based payment arrangements that involve two or more entities within the same Company. An entity shall apply this interpretation for annual periods beginning on or after March 1, 2007.

The Company expects that the adoption of the pronouncements listed above will have no significant impact on the Company's result of operation and financial positions in the period of initial application. The adoption of IFRS 7 will significantly affect the disclosures relating to financial instruments as presented in the notes to the financial statements.

(in thousands roubles)

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

Correction of Errors and Reclassifications

In 2006 the Company restated its obligations existing under the defined benefit plans in accordance with IAS 19, "Employee Benefits". The Company made adjustments to the comparatives as of December 31, 2004 and 2005.

Consolidated balance sheet as at December 31, 2005	As previously reported	Effect of adjustments	As restated	Description of adjustments
Retained earnings	14,507,125	(278,812)	14,228,313	Restatement of pension liabilities as of December 31, 2005, (net of tax effect of nil)
Pension liabilities	827,392	278,812	1,106,204	Restatement of pension liabilities as of December 31, 2005, (net of tax effect of nil)
Consolidated statement of operations for 2005				
Wages, salaries, other benefits and payroll taxes	(7,857,798)	(96,765)	(7,954,563)	Effect of restatement of pension expenses for 2005
Consolidated statement of changes in equity for the year ended 2004				
Retained earnings as of December 31, 2004	12,489,617	(182,047)	12,307,570	Effect of pension liabilities recognized as of December 31, 2004 (net of tax effect of nil)

In addition the Company made the following reclassifications to the 2005 financial statements to conform to the 2006 presentation:

	As reported	Effect of restatements	As restated	Description
Consolidated balance sheet as of December 31, 2005				
Long-term accounts Receivable and other financial assets	20,835	19,096	39,931	Reclassification of Input VAT related to capital construction
Other current assets	1,577,657	(57,909)	1,519,748	Reclassification of Input VAT related to capital construction and reclassification of current income tax asset
Current income tax asset	–	38,813	38,813	Reclassification of current income tax asset from other current assets

3. Summary of Significant Accounting Policies

3.1 Principles of Consolidation

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

Subsidiaries

Subsidiaries, which are those entities in which the Company has an interest of more than one half of the voting rights, or otherwise has the power to exercise control over their operations, are consolidated. The Control is a power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Financial statements of all subsidiaries are included in the consolidated financial statement. 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 Group companies are eliminated; unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. In case of necessity, accounting policies for subsidiaries have been changed to ensure consistency with the policies adopted by the Company.

Acquisition of Subsidiaries

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

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

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

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

Acquisition of Minority Interest in Subsidiaries

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

3. Summary of Significant Accounting Policies (continued)

3.2 Investments in Associates

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

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

3.3 Investments

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

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

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

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

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

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

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

(in thousands roubles)

3. Summary of Significant Accounting Policies (continued)

3.3 Investments (continued)

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

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

3.4 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, 2006 and 2005 were as follows:

Currency	**2006**	**2005**
Russian Roubles per US dollar	**26.33**	28.78
Russian Roubles per Euro	**34.70**	34.19
Russian Roubles per Japanese yen	**0.22**	0.25

3. Summary of Significant Accounting Policies (continued)

3.5 Property, Plant and Equipment

3.5.1 Property, Plant and Equipment

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

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

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

3.5.2 Depreciation and Useful Life

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

Buildings and Constructions	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

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

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

3. Summary of Significant Accounting Policies (continued)

3.5 Property, Plant and Equipment (continued)

3.5.3 Assets Received Free of Charge

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

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

3.6 Intangible Assets

3.6.1 Goodwill

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

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

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

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

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

3. Summary of Significant Accounting Policies (continued)

3.6 Intangible Assets (continued)

3.6.2 Licenses

Cost of licenses paid to Government for permission to provide telecommunication services within identifiable period of time is recognized as intangible assets.

3.6.3 Software and Other Intangible Assets

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

3.6.4 Useful Life and Amortization of Intangible Assets

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

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

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

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

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

3.7 Leases

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

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

3. Summary of Significant Accounting Policies (continued)

3.7 Leases (continued)

3.7.1 Finance Leases

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

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

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

3.7.2 Operating Leases

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

3.8 Financial Instruments

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

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

3. Summary of Significant Accounting Policies (continued)

3.8 Financial Instruments (continued)

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

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

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

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

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

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

3.9 Inventories

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

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

3.10 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. Summary of Significant Accounting Policies (continued)

3.11 Accounts Receivable and Provision for Bad Debt

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

3.12 Loans and Borrowings Received

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

3.13 Employee Benefits

3.13.1 Unified Social Tax

Under provisions of the Russian legislation, social contributions are made through a unified social tax (“UST”) calculated by the Company by the application of a regressive rate (from 26% to 12%) to the annual gross remuneration of each employee. The Company allocates the UST to three social funds (state pension fund, social and medical insurance funds), where the rate of contributions to the pension fund vary from 20% to 10% depending on the annual gross salary of each employee.

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

3.13.2 Current Employment Benefits

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

3.13.3 Pensions and Other Post-Employment Benefit Plans

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

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

Under defined benefit plans, the Company’s obligation is to provide the agreed benefits to current and former employees. In this case actuarial and investment risks fall on the Company.

The Company provides defined benefit pension plan, which require contributions to be made to a separately administered fund. The Company also provides certain additional post-employment benefits and other long-service employees benefits of a defined nature such as lump-sum payments upon retirement and death and financial support to the Company’s old age and disabled pensioners.

3. Summary of Significant Accounting Policies (continued)

3.13 Employee Benefits (continued)

The cost of providing benefits under the defined benefit plan is determined separately for each plan using the projected unit credit actuarial valuation method. Actuarial gains and losses are recognized as income or expense when the net cumulative unrecognized actuarial gains and losses for each individual plan at the end of the previous reporting period exceeded 10% of the higher of the defined benefit obligation and the fair value of plan assets at that date. These gains or losses are recognised over the expected average remaining working lives of the employees participating in the plans.

The past service cost is recognized as an expense on a straight line basis over the average period until the benefits become vested. If the benefits are already vested immediately following the introduction of, or changes to, a pension plan, past service cost is recognised immediately.

The defined benefit asset or liability comprises the present value of the defined benefit obligation less past service cost not yet recognized and less the fair value of plan assets out of which the obligations are to be settled directly. The value of any asset is restricted to the sum of any past service cost not yet recognized and the present value of any economic benefits available in the form of refunds from the plan or reductions in the future contributions to the plan.

3.14 Income Taxes

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

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

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

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

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

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

3. Summary of Significant Accounting Policies (continued)

3.14 Income Taxes (continued)

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

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

Deferred tax assets and liabilities are not discounted.

3.15 Shareholders’ Equity

3.15.1 Share Capital

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

3.15.2 Dividends

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

3.16 Minority Interest

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

3.17 Revenue Recognition

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

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

3. Summary of Significant Accounting Policies (continued)

3.17 Revenue Recognition (continued)

3.17.1 Revenue from Customers

The Company categorizes the revenue sources in twelve major categories:

1. Local telephone calls;
2. Intrazone telephone calls;
3. Installation and connecting fees;
4. Documentary services;
5. Cellular services;
6. Radio and TV broadcasting;
7. Data transfer and telematic services;
8. New services (internet, ADSL, ISDN, IP-telephony);
9. Rent of telephone channels;
10. Services for operators;
11. Other telecommunications services;
12. Other revenues.

The Company recognizes revenues related to all types of services except installation and connection fees in the period when the services are rendered.

Installation and connection fees

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

According to legislative pronouncements starting from January 1, 2006 new rules for rendering of international, intercity and intrazone calls services by operators came into force.

Starting January 1, 2006 the Company does not recognize revenues from domestic and international long-distance calls services as, according to the new rules these services in the Russian Federation are rendered solely by operators who have respective licenses. In 2006 only intrazone calls services are rendered by the Company based on respective license.

In 2005 revenues from intrazone calls services in amount of 2,132,010 were presented together with revenues from domestic long-distance calls (see Note 24).

3. Summary of Significant Accounting Policies (continued)

3.18 Earnings per Share

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

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

3.19 Provisions

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

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

3.20 Contingent Assets and Contingent Liabilities

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

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

3.21 Segment Information

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

3. Summary of Significant Accounting Policies (continued)

3.22 Related Party Transactions

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

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

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

The Company discloses in financial statement information on related party transactions with third parties controlled by government of Russian Federation.

3.23 Events after the Balance Sheet Date

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

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

4. Significant Accounting Judgments and Estimates

4.1 Judgments

In the process of applying the Company's accounting policies, management has made the following judgments, apart from those involving estimates, which have the most significant effect on the amounts recognised in the consolidated financial statements:

Classification of lease agreements

A lease is classified as finance lease if it transfers substantially all the risks and rewards incidental to ownership, otherwise it is classified as operating lease. Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract.

4.2 Estimation Uncertainty

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

Useful life of property, plant and equipment

The Company assesses the remaining useful lives of items of property, plant and equipment at least at each financial year-end. If expectations differ from previous estimates, the changes are accounted for as a change in an accounting estimate in accordance with IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors". These estimates may have a material impact on the amount of the carrying values of property, plant and equipment and on depreciation recognized in profit or loss.

Impairment of property, plant and equipment

The Company assesses at each reporting date whether there is any indication that an asset may be impaired. If any such indication exists, the Company makes an estimate of the asset's recoverable amount. An asset's recoverable amount is higher of an asset's or cash-generating unit's fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or Company of assets. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. 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 assessment of the time value of money and the risks specific to the assets.

The determination of impairments of property, plant and equipment involves the use of estimates that include, but are not limited to, the cause, timing and amount of the impairment. Impairment is based on a large number of factors, such as changes in current competitive conditions, expectations of growth in the industry, increased cost of capital, changes in the future availability of financing, technological obsolescence, discontinuance of service, current replacement costs and other changes in circumstances that indicate impairment exists. The determination of the recoverable amount of a cash-generating unit involves the use of estimates by management. Methods used to determine the value in use include discounted cash flow-based methods, which require the Company to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows. These estimates, including the methodologies used, may have a material impact on the fair value and ultimately the amount of any property, plant and equipment impairment.

4. Significant Accounting Judgments and Estimates (continued)

4.2 Estimation Uncertainty (continued)

Fair values of assets and liabilities acquired in business combinations

The Company is required to recognize separately, at the acquisition date, the identifiable assets, liabilities and contingent liabilities acquired or assumed in the business combination at their fair values, which involves estimates. Such estimates are based on valuation techniques, which require considerable judgment in forecasting future cash flows and developing other assumptions. More details are provided in Note 8.

Impairment of goodwill and intangible assets not yet available for use

The Company determines whether goodwill is impaired at least on an annual basis. This requires an estimation of the value in use of the cash-generating units to which the goodwill is allocated. Estimating the value in use requires the Company to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows. The carrying amount of goodwill at 31 December 2006 was 870,260 (2005: 367,005) and carrying amount of intangible assets not yet available for use at December 31, 2006 was 1,187,090 (2005: 1,836,852). More details are provided in Note 7.

Allowance for doubtful accounts

Management maintains an allowance for doubtful accounts to account for estimated losses resulting from the inability of customers to make required payments. When evaluating the adequacy of an allowance for doubtful accounts, management bases its estimates on the aging of accounts receivable balances and historical write-off experience, customer credit worthiness and changes in customer payment terms. If the financial condition of customers were to deteriorate, actual write-offs might be higher than expected. As of 31 December 2006, allowances for doubtful accounts have been created in the amount of 836,142 (2005: 1,225,044).

Pension obligations

Post-employment benefits are generally satisfied by plans which are classified and accounted for as defined benefit plans. The present value of defined post-employment benefit obligations and related current service cost are determined in accordance with actuarial valuation, which rely on demographic and financial assumptions including mortality, both during and after employment, rates of employee turnover, discount rate, future salary and benefit levels and, to a limited extent, expected return on plan assets. In the event that further changes in the key assumptions are required, the future amounts of the pension benefit costs may be affected materially. More details are provided in Note 23.

4. Significant Accounting Judgments and Estimates (continued)

4.2 Estimation Uncertainty (continued)

Litigations

The Company exercises considerable judgment in measuring and recognizing provisions and the exposure to contingent liabilities related to pending litigations or other outstanding claims subject to negotiated settlement, mediation, arbitration or government regulation, as well as other contingent liabilities. Judgement is necessary in assessing the likelihood that a pending claim will succeed, or a liability will arise, and to quantify the possible range of the final settlement. Because of the inherent uncertainties in this evaluation process, actual losses may be different from the originally estimated provision. These estimates are subject to change as new information becomes available, primarily with the support of internal specialists, if available, or with the support of outside consultants, such as actuaries or legal counsel. Revisions to the estimates may significantly affect future operating results.

Deferred tax assets

Management judgment is required for the calculation of current and deferred income taxes. Deferred tax assets are recognized to the extent that their utilization is probable. The utilization of deferred tax assets will depend on whether it is possible to generate sufficient taxable income in respective tax type and jurisdiction. Various factors are used to assess the probability of the future utilization of deferred tax assets, including past operating results, operational plan, expiration of tax losses carried forward, and tax planning strategies. If actual results differ from that estimates or if these estimates must be adjusted in future periods, the financial position, results of operations and cash flows may be negatively affected. In the event that an assessment of future utilization indicates that the carrying amount of deferred tax assets must be reduced, this reduction is recognized in profit or loss.

(in thousands roubles)

5. Segment Information

	2006			
	Fixed line	**Mobile**	**Intercompany eliminations**	**Total for the Company**
REVENUE				
Sales to third parties	**21,474,361**	**3,374,342**	**–**	**24,848,703**
Inter-segment sales	**155,606**	**634,661**	**(790,267)**	**–**
Total revenue	**21,629,967**	**4,009,003**	**(790,267)**	**24,848,703**
Segment result	**3,284,748**	**991,216**	**–**	**4,275,964**
Unallocated corporate expenses	**–**	**–**	**–**	**–**
Operating profit	**–**	**–**	**–**	**4,275,964**
Share of result of associates	**11,912**	**–**	**–**	**11,912**
Interest expense, net	**(944,082)**	**(76,701)**	**–**	**(1,020,783)**
Gain on sale of subsidiaries, associates and other investments	–	–	**–**	**(48,371)**
Foreign exchange gain, net	**8,464**	**14,169**	**–**	**22,633**
Income tax	**(831,703)**	**(275,218)**	**–**	**(1,106,921)**
Net profit	**–**	**–**	**–**	**2,134,434**
Assets and Liabilities				
Segment assets	**34,216,015**	**6,777,259**	**(297,104)**	**40,696,170**
Investments in associates	**129,103**	**–**	**–**	**129,103**
Consolidated total assets	**–**	**–**	**–**	**40,825,273**
Segment liabilities	**(18,691,598)**	**(2,288,151)**	**297,104**	**(20,682,645)**
Consolidated total liabilities				**(20,682,645)**
OTHER INFORMATION				
Capital expenditure	**6,932,376**	**1,143,423**	**–**	**8,075,799**
Depreciation and amortization	**3,945,306**	**508,655**	**–**	**4,453,961**
Other non-cash expenses:				
Employee benefit liabilities	**181,091**	**–**	**–**	**181,091**

(in thousands roubles)

5. Segment Information (continued)

	2005			
	Fixed line	**Mobile**	**Intercompany eliminations**	**Total for the Company**
REVENUE				
Sales to third parties	20,944,518	2,811,715		23,756,233
Inter-segment sales	327,611	252,380	(579,991)	–
Total revenue	21,272,129	3,064,095	(579,991)	23,756,233
Segment result	3,766,780	856,724	–	4,623,504
Unallocated corporate expenses	–	–	–	–
Operating profit				4,623,504
Share of result of associates	20,713	–	–	20,713
Interest expense, net	(773,877)	(69,655)	–	(843,532)
Gain on sale of subsidiaries, associates and other investments				41,842
Foreign exchange gain, net	31,907	21,211	–	53,118
Income tax	(1,210,833)	(180,788)	–	(1,391,621)
Net profit				2,504,024
Assets and Liabilities				
Segment assets	31,945,120	5,009,427	(105,005)	36,849,542
Investments in associates	119,980	–	–	119,980
Consolidated total assets				36,969,522
Segment liabilities	(16,559,248)	(2,015,528)	105,005	(18,469,771)
Consolidated total liabilities				(18,469,771)
OTHER INFORMATION				
Capital expenditure	5,696,631	1,334,492		7,031,123
Depreciation and amortization	2,998,684	418,975		3,417,659
Other non-cash expenses:				
Provision for impairment of receivables	(2,170)	14,190		12,020
Employee benefit liabilities	214,723	–		214,723
Obsolescence of inventory	2,874	–		2,874

5. Segment Information (continued)

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

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

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

Segments are comprised of separate legal entities who file separate tax returns. Accordingly, income tax expense was allocated to the segments in full.

(in thousands roubles)

6. 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, 2004	**12,267,650**	**12,592,922**	**1,728,914**	**3,445,725**	**30,035,211**
Additions	–	–	6,394,596	–	6,394,596
Additions due to acquisition of subsidiaries	–	55,208	11,703	–	66,911
Disposals	(89,997)	(87,605)	(61,738)	(21,295)	(260,635)
Disposals due to sale of subsidiaries	–	(997)	–	–	(997)
Transfers	2,257,164	3,332,994	(6,649,081)	1,058,923	–
At December 31, 2005	**14,434,817**	**15,892,522**	**1,424,394**	**4,483,353**	**36,235,086**
Additions	(2)	(47,564)	6,954,071	–	6,906,505
Additions due to acquisition of subsidiaries	6,986	143,900	17,558	7,101	175,545
Disposals	(40,629)	(92,233)	(17,035)	(19,222)	(169,119)
Disposals due to sale of subsidiaries	–	(14,630)	–	–	(14,630)
Transfers	1,906,415	3,190,962	(6,568,171)	1,470,794	–
At December 31, 2006	**16,307,587**	**19,072,957**	**1,810,817**	**5,942,026**	**43,133,387**
Accumulated depreciation					
At December 31, 2004	**(1,009,123)**	**(2,524,450)**	**–**	**(898,132)**	**(4,431,705)**
Charge for the year	(747,223)	(1,840,913)	–	(729,854)	(3,317,990)
Charge due to acquisition of subsidiaries	–	–	–	–	–
Disposals	14,027	20,126	–	5,573	39,726
Disposals due to sale of subsidiaries	–	493	–	–	493
At December 31, 2005	**(1,742,319)**	**(4,344,744)**	**–**	**(1,622,413)**	**(7,709,476)**
Charge for the year	(915,400)	(2,037,798)	–	(1,170,417)	(4,123,615)
Charge due to acquisition of subsidiaries	–	–	–	–	–
Disposals	10,091	11,845	–	10,116	32,052
Disposals due to sale of subsidiaries	–	–	–	–	–
At December 31, 2006	**(2,647,628)**	**(6,370,697)**	**–**	**(2,782,714)**	**(11,801,039)**
Net book value as of December 31, 2004	**11,258,527**	**10,068,472**	**1,728,914**	**2,547,593**	**25,603,506**
Net book value as of December 31, 2005	**12,692,498**	**11,547,778**	**1,424,394**	**2,860,940**	**28,525,610**
Net book value as of December 31, 2006	**13,659,959**	**12,702,260**	**1,810,817**	**3,159,312**	**31,332,348**

(in thousands roubles)

6. Property, Plant and Equipment (continued)

As at December 31, 2006 bank borrowings are secured by properties with the carrying value of 5,692,786 (2005 – 8,182,160).

The net book value of plant and equipment held under finance leases at December 31, 2006 and 2005 amounted to:

	2006	2005
Switches and transmission devices	**2,317,078**	1,592,034
Vehicles and other	**59,941**	60,114
Construction in progress and equipment for installation	**9,839**	31,935
Buildings and constructions	–	13,660
Total net book value of plant and equipment held under finance leases	**2,386,858**	1,697,743

The net book value of property, plant and equipment, which were received on vendor financing terms, amounted as of December 31, 2006 to 2,508,109 (2005 – 1,383,052).

In 2006, the Company increased construction in progress by the amount of capitalized interest totaling 16,849 (2005 – 167,935). Capitalization rate in 2006 was 9.5% (2005 - 15%).

The assets transferred to the Company upon privatization do not include the land on which the Company's buildings, comprising the Company's principal operating facilities, are situated. The land on which the Company's operating facilities are situated is rented by the Company from local authorities under the operating lease agreements. These lease agreements are signed for one year and may be prolongated by the Company without significant additional costs. Lease payments for land related to Company's operating facilities can be changed subject to agreement by the parties. The future minimum lease payments under non-cancellable operating leases of land are disclosed in note 32.

(in thousands roubles)

7. Intangible Assets and Goodwill

Cost	**Goodwill**	**Licenses**	**Software**	**Other**	**Total**
At December 31, 2004	325,097	181,380	1,662,405	99,525	2,268,407
Additions	–	4,340	631,724	463	636,527
Additions due to acquisition of subsidiaries	41,908	–	171	–	42,079
Disposals	–	(10)	(633)	(90)	(733)
Disposals due to sale of subsidiaries	–	–	(1)	–	(1)
At December 31, 2005	367,005	185,710	2,293,666	99,898	2,946,279
Additions	–	52,353	1,068,324	1,051	1,121,728
Additions due to acquisition of subsidiaries	503,255	–	563	425,200	929,018
Disposals	–	(37)	(7,106)	(11,450)	(18,593)
At December 31, 2006	**870,260**	**238,026**	**3,355,447**	**514,699**	**4,978,432**
Accumulated amortization					
At December 31, 2004	–	(31,427)	(45,858)	(23,654)	(100,939)
Charge for the year	–	(17,545)	(74,006)	(8,118)	(99,669)
Charge due to acquisition of subsidiaries	–	–	(140)	–	(140)
Disposals	–	–	84	–	84
Disposals due to sale of subsidiaries	–	–	–	–	–
At December 31, 2005	–	(48,972)	(119,920)	(31,772)	(200,664)
Charge for the year	–	(22,628)	(274,441)	(33,277)	(330,346)
Charge due to acquisition of subsidiaries	–	–	–	–	–
Disposals	–	–	–	6,767	6,767
Disposals due to sale of subsidiaries	–	–	–	–	–
At December 31, 2006	–	(71,600)	(394,361)	(58,282)	(524,243)
Net book value at December 31, 2004	325,097	149,953	1,616,547	75,871	2,167,468
Net book value at December 31, 2005	367,005	136,738	2,173,746	68,126	2,745,615
Net book value at December 31, 2006	**870,260**	**166,426**	**2,961,086**	**456,417**	**4,454,189**

Oracle E-Business Suite (OEBS)

As of December 31, 2006 software includes OEBS software with a gross book value of 1,167,626 (2005 – 1,121,410), including interest capitalized of 211,813 (2005 – 211,813). Capitalization rate in 2006 was 0% (2005 - 15%). In accordance with the supply contract, the Company acquired non-exclusive licenses for 13,029 users of E-business Suite 2004 Professional among other license applications.

The Company commenced the commercial operation of OEBS in relation to the module for accounting for non-current assets, the Release #1, in line with the pilot stage of the completion of the installation in Kirov and Head Office branches on December 30, 2005. In 2006 implementation of the module, release #1, was completed in all of the Company's branches.

In 2006 the Company used OEBS in relation to the modules for accounting for non-current assets and maintaining payroll registers.

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

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

7. Intangible Assets and Goodwill (continued)

Amdocs Billing Suite

As of December 31, 2006 software includes Amdocs Billing Suite software with a gross book value of 1,187,090 (2005 – 715,442), including the interest from promissory notes capitalized totaling 34,232 (2005 – 31,088). The capitalization rate in 2006 was 6% (2005 – 6%). 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.

Amdocs Billing Suite software was supplied in December 2004 by LLC IBM Eastern Europe/Asia, in exchange for zero coupon promissory notes in the total amount of 755,662. As of December 31, 2006 the Company fully repaid the promissory notes.

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

HP Open View IUM Hewlett-Packard

As of December 31, 2006 software also includes HP Open View IUM Hewlett-Packard software purchased in 2006 from CJSC "ISG" with a gross book value of 398,951 (2005 –nil), including interest capitalized of 14,108 (2005 – nil). The capitalization rate in 2006 was 8.59%. The project of implementation of the software is expected to be completed by 2008.

Licenses

As of December 31, 2006 licenses mainly included GSM 900 licenses with a net book value of 166,426 (2005 – 136,738). 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.

Amortization charge of Intangible assets for 2006 in the amount of 330,346 (2005 – 99,669) was recorded in line Depreciation and Amortization of Consolidated Statement of Operations.

Impairment testing of goodwill

Goodwill acquired through business combinations has been allocated to united mobile operator which the Company plans to create in 2007 by merger of its cellular subsidiaries as a single cash-generating unit for impairment testing. The following subsidiaries form united mobile operator:

- CJSC "Nizhegorodskaya Sotovaya svyaz"
- OJSC "Tatincom-T"
- CJSC "RTCOM"
- LLC "Nizhegorodsky teleservice"
- CJSC "Penza Mobile"
- CJSC "Chuvashia Mobile"
- CJSC "Saratov Mobile"
- Other subsidiaries

(in thousands roubles)

7. Intangible Assets and Goodwill (continued)

The recoverable amount of the united mobile operator’s cash-generating unit have been determined based on a value in use calculation using cash flow projections based on financial budgets approved by senior management covering a five-year period. Cash flows beyond the five-year period are extrapolated using a 0% growth rate (2005 - 0.5%) which the same as the long-term average growth rate for the above mentioned cash-generating unit. The discount rate applied to cash flow projections is 14% (2005 - 16%).

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

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

Carrying amount of goodwill allocated to the cash-generating unit comprised the following:

	Carrying amount of goodwill	
Subsidiary	**2006**	**2005**
OJSC “Tatincom”	**323,811**	323,811
CJSC “RTCOM”	**33,075**	33,075
LLC “Nizhegorodsky teleservice”	**8,833**	8,833
CJSC “Penza Mobile”	**119,226**	–
CJSC “Chuvashia Mobile”	**222,536**	–
CJSC “Saratov Mobile”	**161,493**	–
Other subsidiaries	**1,286**	1,286
Total	**870,260**	367,005

As of December 31, 2006 no impairment was identified by the Company.

Impairment test of intangible assets not yet available for use

The Company performed impairment tests of intangible assets not yet available for use. These assets represent cost of Amdocs Billing Suite totaling 1,187,090 at December 31, 2006 (as at December 31, 2005 – 1,836,852, including Oracle in amount of 1,121,410). As at December 31, 2006 no impairment was identified.

(in thousands roubles)

8. Consolidated Subsidiaries

The consolidated financial statements include the assets, liabilities and financial results of OJSC “VolgaTelecom” and its subsidiaries, whose main activity is provision of cellular and other telecommunication services. The subsidiaries are listed below:

		Ownership,%		Voting Shares	
Subsidiary	**Main Activity**	**2006**	**2005**	**2006**	**2005**
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
LLC Russian-American SP “Izhcom”	Data transmission and telematic services	–	100	–	–
LLC “VyatkaSvyazService”	Paging services	**100**	100	–	–
CJSC “Transsvyaz”	Local telephone network services	**100**	80	**100**	80
OJSC “Omrix”	Local telephone network services	**74**	74	**74**	74
CJSC “Ulianovsk –GSM”	Cellular services(GSM-900)	**60**	60	**60**	60
CJSC “Orenburg GSM”	Cellular services(GSM-900)	**51**	51	**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
CJSC “RTCOM”	Cellular services	**100**	100	**100**	100
LLC “Nizhegorodsky teleservice”	Local telephone services	**100**	100	–	–
CJSC “Nizhegorodteleservice”	Establishment and operation of integration system	**100**	60	**100**	60
CJSC “Penza Mobile”	Cellular services	**100**	40	**100**	40
CJSC “Chuvashia Mobile”	Cellular services	**100**	30	**100**	30
CJSC “Saratov Mobile”	Cellular services	**100**	50	**100**	50

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

On March 9, 2005 in accordance with the decision of the Board of Directors dated December 22, 2004 the Company acquired a 100% stake in CJSC “RTCOM” (8,248 ordinary shares) for 10,130. The subsidiary was purchased for the purpose of rendering cellular services in the Mordovia region as part of the Company’s mobile business development program. Management believes that the fair value of CJSC “RTKOM” identifiable assets, liabilities and contingent liabilities as at the acquisition date approximated their book value.

In July 2005 the Company acquired a 100% stake in LLC “Nizhegorodsky teleservice” from LLC “Invekt” for 43,728. The subsidiary was purchased for the purpose of expansion of data transfer and telematic services rendered by the Company. Management believes that the fair value of LLC “Nizhegorodsky teleservice” identifiable assets, liabilities and contingent liabilities as at acquisition date approximated their book value.

(in thousands roubles)

8. Consolidated Subsidiaries (continued)

On September 18, 2006 in accordance with the decision of the Board of Directors dated June, 2006 the Company acquired a 50% stake in CJSC "Saratov Mobile" (3,300,726 ordinary shares), a 70% stake in CJSC "Chuvashia Mobile" (1,171,000 ordinary shares) and a 60% stake in CJSC "Penza Mobile" (1,815,000 ordinary shares) for 239,695, 272,064 and 116,471, respectively. The subsidiaries were purchased for the purpose of rendering cellular services in the Saratov, Penza regions and Chuvashia Republic, regions as part of the Company's mobile business development program.

Management assigned the acquisition price for the purchased Subsidiaries as follows:

	CJSC "Saratov Mobile"		CJSC "Chuvashia Mobile"		CJSC "Penza Mobile"	
Cost						
Acquisition price	239,695		272,064		116,471	
Transaction costs	–		–		–	
Total paid	**239,695**		**272,064**		**116,471**	
	Fair value	**Carrying amount**	**Fair value**	**Carrying amount**	**Fair value**	**Carrying amount**
Property, plant and equipment, net	105,097	108,838	66,188	64,778	2,901	6,492
Intangible assets, net	302,784	562	121,880	31	1,099	704
Other Non-current Assets	397	2,406	–	1,432	176	–
Accounts receivable	6,140	6,429	1,091	1,066	109	164
Cash and cash equivalents	16,794	16,794	1,204	1,204	11,063	11,063
Other current assets	5,900	6,912	4,149	7,226	778	4,672
Current liabilities	(111,594)	(114,551)	(47,635)	(48,641)	(14,824)	(14,822)
Long-term liabilities	(169,114)	(120,474)	(76,122)	(57,140)	(5,893)	(7,073)
Total net assets	**156,404**	**(93,084)**	**70,755**	**(30,044)**	**(4,591)**	**1,200**
Company's share in acquired net assets	50%		70%		60%	
Assigned value of acquired share in identifiable net assets	78,202		49,528		(2,755)	
Amount of goodwill at December 31, 2006, net	**161,493**		**222,536**		**119,226**	

Goodwill is mainly attributable to economic potential of the market assuming low regional penetration level as of the date of acquisition.

Loss of CJSC "Saratov mobile", CJSC "Chuvashia mobile" and CJSC "Penza mobile" for 2006 year from the date of acquisition was 13,723, 12,379 and 3,974 correspondingly. If the combination had taken place at the beginning of the year, the profit of the Company would have been 2,114,591 and revenue would have been 24,998,054.

(in thousands roubles)

8. Consolidated Subsidiaries (continued)

On August 11, 2006 the Company acquired additional 40% stake in CJSC "Nizhegorodteleservice" (120,000 ordinary shares) for 2,510 (increased its share to 100%). Management believes that the fair value of CJSC "Nizhegorodteleservice" identifiable assets, liabilities and contingent liabilities as at the acquisition date approximated their book value. The difference between cost of additional interest in the subsidiary and minority interest's share of the assets and liabilities in the amount of 12 and was reflected as an equity transaction.

On August 11, 2006 the Company acquired additional 20% stake in CJSC "Transsvyaz" (800 ordinary shares) for 2,052 (increased its share to 100%). Management believes that the fair value of CJSC "Transsvyaz" identifiable assets, liabilities and contingent liabilities as at the acquisition date approximated their book value. The difference between cost of additional interest in the subsidiary and minority interest's share of the assets and liabilities in the amount of 313 and was reflected as an equity transaction.

Disposal of shares in subsidiaries for 2006 is presented below:

Name	**Main activity**	**Carrying amount of net assets disposed**	**Proceeds from sale**	**Sale/disposal of share in equity on the date of transaction, %**
LLC Russian-American SP "Izhcom"	Data transmission and telematic services	21,932	–	100
CJSC "Telesvyazinform"	Cable and air TV services	8	6	100
Total			**6**	

In November 2006 in accordance with the decision of the Board of Directors dated November 7, 2006 the Company wrote off to losses the investments in LLC Russian-American SP "Izhcom" in the amount of 4,471 and CJSC "Telesvyazinform" in the amount of 4 due to their liquidation.

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

9. Investments in Associates

Investments in associates at December 31, 2006 and 2005 comprised the following:

		2006		**2005**	
Associate	**Activity**	**Voting shares**	**Carrying value**	**Voting shares**	**Carrying value**
CJSC "Samara Telecom"	Local telephone network services	**28%**	**109,073**	28%	96,925
CJSC "ACB S-Bank"	Banking services	**42%**	**20,030**	42%	19,178
Other	Cellular services	**–**	**–**	40%	3,877
Total			**129,103**		119,980

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

(in thousands roubles)

9. Investments in Associates (continued)

Movement in investments in associates for the years ended December 31, 2006 and 2005 is presented below:

	2006	2005
Investments in associates at January 1	**119,980**	110,096
Share of income net of income tax, and of dividends received	**11,912**	20,713
Reclassifications of financial investments	**(2,789)**	–
Sale of associates	–	(10,829)
Investments in associates at December 31	**129,103**	119,980

The carrying values of investments in associates presented in these consolidated financial statements is equivalent to the Company's share in the net assets of the associates.

The following table illustrates summarized financial information of the associates:

Associate	Voting shares	Assets	Liabilities	Revenues	Net income/(loss)
2006					
CJSC "Samara Telecom"	**28%**	**462,964**	**(70,617)**	**259,529**	**43,695**
ACB "S-Bank"	**42%**	**250,293**	**(202,293)**	**10,949**	**1,581**
2005					
CJSC "Samara Telecom"	28%	404,853	(56,201)	254,413	69,176
CJSC "Saratov-Mobile"	50%	144,787	(238,602)	121,642	(18,457)
ACB "S-Bank"	42%	199,003	(153,046)	9,945	6,187
CJSC "Chuvashiya Mobile"	30%	90,402	(109,456)	37,133	(16,803)

10. Long-term Investments

As of December 31, 2006 and 2005, the Company's investments comprised the following:

	2006		2005	
Company	**Ownership interest**	**Carrying amount**	**Ownership interest**	**Carrying amount**
OJSC "Informatsionnye Tehnologii Svyazy" (OJSC "Svyazintech")	**13%**	**14,880**	13%	14,880
CJSC "RusleasingSvyaz"	**7.3%**	**12,293**	7.3%	12,293
OJSC "AlfaBank" promissory notes	**–**	**2,583**	–	2,583
OJSC "Svyaz-bank"	**0.05%**	**3,987**	0.05%	3,987
OJSC "Sberbank RF"	**0.0003%**	**5,437**	0.0003%	2,137
CJSC "TeleRoss-Samara"	**10.0%**	**990**	10.0%	990
CJSC "Reg-time"	**17.0%**	**570**	17.0%	570
OJSC NTK "Zvezda"	**1.668%**	**47,682**	1.334%	1
Other		**2,312**		2,290
Impairment provision		**(62,508)**		(14,821)
Total investment available-for-sale, net		**28,226**		24,910

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

(in thousands roubles)

10. Long-term Investments (continued)

Purchase of share in OJSC NTK "Zvezda"

In accordance with the resolution of the Company's Board of Directors dated on 18 January 2006 the Company acquired 0.334% of shares in OJSC "National television company "Zvezda" (hereafter – OJSC "NTK "Zvezda") (352 ordinary shares of additional emission) for 47,681 on January 23, 2006 with the purpose of Company's business development, creation of information content and TV broadcasting provided by the company. OJSC "NTK "Zvezda" commenced broadcasting in February 2005. As at the balance sheet date the Company performed analysis of financial position of NTK "Zvezda" and other publicly available information. Results of the analysis did not give reasonable basis to support a conclusion that the investment will be recovered in the nearest future by cash flows generated by NTK "Zvezda". Due to the fact that reliable forecasts are not available the Company made a conservative decision to create provision for impairment for investment to NTK "Zvezda" in amount of 48,682.

11. Long-term Accounts Receivable and Other Assets

As of December 31, 2006 and 2005 long-term accounts receivable and other assets comprised the following:

	2006	2005
Long-term accounts receivable	**4,450**	5,083
Long-term loans given to employees	**12,391**	15,752
Long-term VAT recoverable	**18,221**	19,096
Total	**35,062**	39,931

12. Long-Term Advances Given

As of December 31, 2006 and 2005 long-term advances given to suppliers of equipment comprised the following:

	2006	2005
Advances given for capital construction	**366,240**	483,900
Acquisition and implementation of Oracle E-Business Suite software	**106,877**	124,429
Implementation of Amdocs Billing Suite software	**44,538**	140,726
Total	**517,655**	749,055

13. Inventories

Inventories at December 31, 2006 and 2005 comprised the following:

	2006	2005
Cable, materials and spare parts for telecommunications equipment	**206,477**	194,382
Construction materials, fuels and instruments	**66,290**	84,808
Finished goods and goods for resale	**60,175**	57,455
Other inventories	**203,325**	210,316
Provision for inventory obsolescence	**(342)**	(2,874)
Total	**535,925**	544,087

In 2006 gain from recovery of Inventory obsolescence provision amounted to 2,532 (2005 – expenses in amount 2,874) is included as "Other operating expenses" in the Consolidated Statement of Operations.

(in thousands roubles)

14. Accounts Receivable

Accounts receivable as of December 31, 2006 and 2005 comprised the following:

	2006	2005
Trade receivables – telecommunication services	**2,708,442**	2,521,055
Provision for impairment of receivables	**(836,142)**	(1,225,044)
Total	**1,872,300**	1,296,011

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

	2006	2005
Corporate customers	**1,185,864**	482,771
Residential customers	**930,029**	934,046
Government customers	**116,513**	146,781
Tariff compensation from the state budget	**476,036**	957,457
Total	**2,708,442**	2,521,055

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 several cases the Company levied fines for delay in payment and reimbursed debt through court of arbitration decisions.

As of December 31, 2006 debt for tariff compensation from the state budget related to granting privileges to certain categories of subscribers amounted to 18% of total accounts receivable (2005 - 38%).

In 2006 the Company collected from the federal budget accounts receivable for tariff compensation in amount of 474,000.

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

	2006	2005
Balance at January 1	**1,225,044**	1,311,923
Provision for the year	**(320,540)**	12,020
Trade receivables write-off	**(71,419)**	(98,899)
Provision of subsidiaries acquired	**3,057**	–
Balance at December 31	**836,142**	1,225,044

The net gain on recovery of provision for impairment for 2006 in the amount of 320,540 (2005 – impairment loss in amount of 12,020) was recognized in line Provision for impairment of receivables in the Consolidated Statement of Operations.

(in thousands roubles)

15. Other Current Assets

As of December 31, 2006 and 2005 other current assets comprised the following:

	2006	2005
VAT receivable	**443,008**	837,817
Accounts receivable for non-core activities	**163,685**	259,085
Deferred expenses	**139,263**	151,866
Prepayments and advance payments	**160,619**	133,534
Other prepaid taxes	**21,486**	20,346
Settlements with personnel	**11,805**	13,981
Short-term loans given	**955**	3,869
Other	**158,475**	99,250
Total	**1,099,296**	1,519,748

16. Cash and Cash Equivalents

As of December 31, 2006 and 2005 cash and cash equivalents comprised the following:

	2006	2005
Cash at bank and on hand	**461,417**	1,308,670
Short-term deposits	–	30,043
Total cash and cash equivalents	**461,417**	1,338,713

17. Significant Non-Cash Transactions

In 2006 the Company received telecommunication equipment under leasing terms in the amount of 943,015 (2005 – 374,114).

Gross book value of property, plant and equipment, which were received on vendor financing terms in 2006, amounted to 317,268 (2005 – 423,372).

The Company received equipment contributions in 2006 in the amount of 2,093 (2005 – 13,266).

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

(in thousands roubles)

18. Share Capital

The total number of outstanding shares comprises:

	Number of shares outstanding (thousands)	Par value	Carrying value
As at December 31, 2004	**327,953**	**1,639,765**	**3,853,690**
Preference	81,983	409,917	963,366
Ordinary	245,970	1,229,848	2,890,324
As at December 31, 2005	**327,953**	**1,639,765**	**3,853,690**
Preference	81,983	409,917	963,366
Ordinary	245,970	1,229,848	2,890,324
As at December 31, 2006	**327,953**	**1,639,765**	**3,853,690**

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 accumulated trough January 1, 2003.

The ordinary shareholders are entitled to one vote per share.

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

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

Distributable earnings of the parent company are limited to its retained earnings, as mandated by the statutory accounting rules. Statutory retained earnings of the Company as of December 31, 2006 and 2005 amounted to 12,687,445 and 10,746,158, respectively.

In accordance with the Russian legislation, dividends may only be declared to the shareholders of the Company from net income as shown in the Company's Russian statutory financial statements. The Company reported net income of 2,453,588 and 2,255,612 in its statutory financial statements in 2006 and 2005, respectively.

(in thousands roubles)

18. Share Capital (continued)

Dividends were declared in 2006 in respect of 2005 results to holders of ordinary shares and preference shares of Rouble 1.4744 per ordinary share (2005 – Rouble 1.3779 per ordinary share) and Rouble 2.7583 per preference share (2005 –Rouble 2.5082 per preference share). See also Note 30.

In October 1997 the Company registered Level 1 American Depositary Receipts (ADR). Each ADR represents 2 shares of common stock of the Company.

The following table represents ADR registration for 2004-2006:

	ADR (quantity)	Ordinary shares equivalent (quantity)	Ordinary shares %	Charter capital %
December 31, 2004	17,657,870	35,315,740	14.36%	10.77%
Additions 2005	4,536,988	9,073,976	–	–
December 31, 2005	22,194,858	44,389,716	18.05%	13.54%
Disposals 2006	(3,301,227)	(6,602,454)	(2.68%)	(2.01%)
December 31, 2006	**18,893,631**	**37,787,262**	**15.37%**	**11.53%**

Currently ADR are traded on the following stock markets:

Stock market	CUSIP(WKN)	ADR ticker	ISIN
Over-the-counter (OTC) market (USA)	928660109	VLGAY	
Frankfurt Stock Exchange (FSE)	910415	NZH	US9286601094
Berlin Stock Exchange (BerSE)	910415	NZH	US9286601094
Xetra	910415	NZH	US9286601094
Stuttgart Stock Exchange (SSE)	910415	NZH	US9286601094

The Company's shareholding structure as of December 31, 2006 was as follows:

	Ordinary shares		Preference shares		
	Number (thousands)	%	Number (thousands)	%	Total
OJSC "Svyazinvest"	124,634	50.67	–	–	124,634
Other legal entities	73,592	29.92	60,820	74.19	134,412
ADR holders	37,787	15.36	–	–	37,787
Individuals	9,957	4.05	21,163	25.81	31,120
Total	**245,970**	**100**	**81,983**	**100**	**327,953**

(in thousands roubles)

19. Borrowings

As of December 31, 2006 and 2005 borrowings comprised the following:

	Effective interest rate	Maturity date	2006	2005
Short-term borrowings				
Bank loans:				
Bank loans (Roubles)	6,75-16%	**2007**	**1,493,960**	559,153
Bank loans (Euro)	Euribor+3,25%	**2007**	**18,283**	76,982
Total bank loans			**1,512,243**	636,135
Accrued interest on bonds (Roubles)	8,54-8,91%	**2007**	**55,969**	45,210
Vendor financing:				
Vendor financing (Roubles)	9.23%-12.24%	**2007**	**283**	1,089
Vendor financing (US Dollars)	6,5-9,23%	**2007**	**104**	61
Vendor financing (Euro)		**2007**	**–**	1
Total vendor financing			**387**	1,151
Accrued interest on promissory notes (Roubles)	8,59%	**2007**	**14,108**	–
Accrued interest on promissory notes (US Dollars)		**2006**	–	1,245
Total short-term borrowings			**1,582,707**	683,741
Long-term borrowings				
Bank loans:				
Bank loans (Roubles)	7-12,24%	2007-2011	**637,972**	2,890,246
Bank loans (US Dollars)	Libor+3,25%	2007-2008	**142,372**	
Bank loans (Euro)	6.5%, Euribor+3.25%	2007-2011	**200,003**	307,200
Total bank loans			**980,347**	3,197,446
Bonds (Roubles)	**8,54-8,91%**	**2007-2013**	**8,262,264**	6,262,076
Vendor financing:				
Vendor financing (Roubles)	9,23-33%	2007-2012	**95,129**	169,187
Vendor financing (US Dollars)	9,23-12,24%	2007-2008	**307,774**	141,158
Vendor financing (Euro)	6,37%	2007-2008	**165,933**	259,251
Total vendor financing			**568,836**	569,596
Promissory notes (Roubles)	**8,59%**	**2007-2009**	**393,570**	–
Promissory notes (US Dollars)	**5,97%**	**2006**	**–**	260,420
Less: Current portion of long-term borrowings			**(707,181)**	(2,699,872)
Total long-term borrowings			**9,497,836**	7,589,666

(in thousands roubles)

19. Borrowings (continued)

As of December 31, 2006 short-term borrowings included interest payable in the amount of 109,246 (2005 – 162,284).

As of December 31, 2006 bank loans are secured by property, plant and equipment with the carrying value of approximately 5,692,786 (2005 – 8,182,160).

As of December 31, 2006, borrowings had the following maturity schedule:

Maturity date	Bank loans	Bonds	Vendor financing	Promissory notes	Total
2007	1,703,889	55,969	388,393	141,638	**2,289,888**
2008	535,211	1,022,834	114,835	114,592	**1,787,472**
2009	143,821	2,120,000	6,199	151,448	**2,421,469**
2010	66,361	2,120,000	38,261	–	**2,224,622**
2011 and after	43,308	2,999,430	21,535	–	**3,064,273**
Total	**2,492,590**	**8,318,233**	**569,223**	**407,678**	**11,787,724**

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

Currency	2006	2005
Russian Roubles	**10,953,255**	9,926,961
US dollars	**450,250**	402,884
Euro	**384,219**	643,434
Total	**11,787,724**	10,973,279

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

Short-term Borrowings

Bank Loans

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

OJSC Sberbank

Short-term borrowings from Sberbank represent Rouble denominated loans received in 2006. The loans mature in 2007. The loans bear interest of 6.75%. As of December 31, 2006, the outstanding amount was 600,111. The loans are secured with property, plant and equipment valued at 1,367,496.

AB Gazprombank CJSC

Short-term borrowings from Gazprombank represent Rouble denominated loans received in 2006. The loans mature in 2007. The loans bear interest of 9%. As of December 31, 2006, the outstanding amount was 442,979. The loans are secured with property, plant and equipment valued at 3,515.

19. Borrowings (continued)

International Moscow Bank CJSC

Short-term borrowings from International Moscow Bank CJSC represent Rouble denominated loans received in 2006. The loans mature in 2007-2008. The loans bear interest of Euribor+3.25-11%. As of December 31, 2006, the outstanding amount was 313,877. The loans are secured with property, plant and equipment valued at 1,866,126.

Long-term Loans and Borrowings

Bank Loans and Borrowings

International Moscow Bank CJSC

Long-term borrowings from International Moscow Bank CJSC represent Rouble denominated loans received in 2006. The loans mature in 2008. The loans bear interest of 8.6%. As of December 31, 2006, the outstanding amount was 320,000.

Foundation «Sozidanie»

Long-term borrowings from Foundation "Sozidanie" represent a Rouble denominated loans received in 2005-2006. The loans mature in 2009-2011. The loan agreements do not provide for interest payments thus the amount of liability as at December 31, 2006 was reported at the present value of future payments using a discount factors of 12.24% and 9.23%, which approximate a weighted average interest rate on the Company's similar interest bearing borrowings obtained in appropriate periods. The amount outstanding as of December 31, 2006 was 138,765. The loans are not secured.

Ministry of Finance of Russian Federation

In 1995-1996, the Ministry of Finance of the Russian Federation provided long-term financing to the Company to purchase telecommunications equipment from various foreign vendors. Vnesheconombank acted as the agent on behalf of the Government of Russian Federation. The loans are denominated in EURO. In July 2005 the Company received a claim from the Ministry of Finance of the Russian Federation for immediate repayment of outstanding amount overdue to the bank equal 226,890 (6,637 thousands EURO) as at the date of receiving the claim.

In December 2006 at the stage of legal proceedings the Company signed an amicable agreement with Ministry of Finance. On March 21, 2006 terms of the amicable agreement was approved by Arbitrary Court of Nizhny Novgorod region. The amicable agreement came into force on December 27, 2006 and stipulated a restructuring of the Company's liability on the following terms: liability on penalty interest accrued for non-timely payments was forgiven and remaining amount of restructured liability would be paid in equal annual payments by January 1, 2012.

The gain on the forgiven of penalty interest payable in the amount of 92,111 (2,662 thousands EURO) is included in line Other operating revenues (expenses), net.

As at December 31, 2006 the outstanding restructured liability to the Ministry of Finance amounted to 143,804 (4,146 thousands Euro), including short term part in the amount of 28,704 (826 thousands Euro). Interest on restructured liability is accrued at effective rate 6.5% and payable annually not later than on December 31 each year. The liability is secured by property, plant and equipment valued at 388,559.

19. Borrowings (continued)

Bonds

In February 2003, the Company registered the issue of 1,000,000 interest-bearing bonds, series VT-1, with a par value of 1,000 Roubles each. The bonds have 12 quarterly coupons. The effective interest rate of the coupon is set at 13.98% per annum. In February 2006, the bonds were fully repaid.

In December 2005, the Company registered the issue of 3,000,000 interest-bearing bonds, series VT-2, with a par value of 1,000 Roubles each. The effective interest rate is set at 8.64% per annum. The bonds mature in 5 years from the date of issue in December 2010. The bond issue has an option of early redemption at par value on December 4, 2008.

In December 2005, the Company registered the issue of 2,300,000 interest-bearing bonds, series VT-3, with a par value of 1,000 Roubles each. The effective interest rate is set at 8.91% per annum. The bonds mature in 5 years from the date of issue in December 2010. The bonds do not provide any put options.

In September 2006, the Company registered the issue of 3,000,000 interest-bearing bonds, series VT-4, with a par value of 1,000 Roubles each. The effective interest rate is set at 8.54% per annum. The bonds mature in 7 years from the date of issue in December 2013. The bond issue has an option of early redemption at par value on September 10, 2009.

Vendor Financing

ALSiTEK

In 2004-2005 the Company entered into several agreements with ALSiTEK, under which it delivered telecommunication equipment to the Company. These agreements bear an effective interest rate of 9.23% and 12.24% in 2006. The amount outstanding as of December 31, 2006 was 27,993. Equipment received under these agreements is pledged to the supplier until the final payment is made.

Alcatel

The Company’s long-term liabilities to Alcatel represent amounts payable for the telecommunication equipment under contracts signed in 2004-2005. The amount outstanding as of December 31, 2006 was 165,933. The amounts payable under these agreements are denominated in Euro. These agreements bear an effective interest rate of 6.37%. Equipment received under these agreements is pledged to the supplier until the final payment is made.

BETO-Huawei

In 2004 the Company entered into several agreements with Beto-Huawei denominated in US Dollars, under which it delivered telecommunication equipment to the Company. These agreements bear an effective interest rate of 6.5% and 9.23%. The amount outstanding as of December 31, 2006 was 4,657. Equipment received under these agreements is pledged to the supplier until the final payment is made.

(in thousands roubles)

19. Borrowings (continued)

Huawei Technologies Co. Ltd.

The Company's long-term liabilities to Huawei Technologies Co. Ltd represent amounts payable for the telecommunication equipment under contracts signed in 2005. The amount outstanding as of December 31, 2006 was 36,699. The amounts payable under these agreements are denominated in US Dollars. These agreements bear an effective interest rate of 9.23%. Equipment received under these agreements is pledged to the supplier until the final payment is made.

Metrosvyaz Limited

The Company's long-term liabilities to Metrosvyaz Limited represents amounts payable for the equipment and CDMA services under contracts signed in 2005. The amount outstanding as of December 31, 2006 was 89,174. The amounts payable under these agreements are denominated in US Dollars. These agreements bear an effective interest rate of 11%. Equipment received under these agreements is pledged to the supplier until the final payment is made.

Promissory Notes

In July 2006 the Company purchased HP Open View IUM Hewlett-Packard software from CJSC "ISG" for the implementation of data collection and processing system (Note 7).

In relation to purchasing the software the Company issued Rouble denominated promissory notes in the amount of 393,570. Payment of the promissory notes is planned in 2007-2009.

The outstanding amount as at December 31, 2006 was 393,570. The effective interest rate is equal to 8.59% per annum.

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, 2006 and 2005 are as follows:

	2006		**2005**	
	Minimum lease payments	**Present value of payments**	**Minimum lease payments**	**Present value of payments**
Current portion	**991,405**	**797,152**	536,921	359,300
2 to 5 years	**741,603**	**596,296**	930,892	727,768
Over 5 years	**274**	**220**	–	–
Total minimum lease payments	**1,733,282**	**–**	1,467,813	–
Less amounts representing finance charges	**(339,614)**	**–**	(380,745)	–
Present value of minimum lease payments	**1,393,668**	**1,393,668**	1,087,068	1,087,068
Less: Current portion of finance lease obligations	**(991,405)**	**(797,152)**	(536,921)	(359,300)
Total long-term finance lease obligations	**741,877**	**596,516**	930,892	727,768

In 2006 and 2005, the Company's primary lessor was OJSC "RTC-Leasing". In 2006, the effective interest rate on lease liabilities ranged from 16.82% to 30.66% per annum (2005 - 16.03% to 36.36% per annum).

OJSC "RTC-Leasing" purchases telecommunication equipment from domestic and foreign suppliers and provides such equipment to the Company under finance lease agreements. The Company's obligations under finance leases to OJSC "RTC-Leasing" as of December 31, 2006 amounted to 1,386,899 (2005 – 1,057,915). Further, the Company guarantees to OJSC "RTC-Leasing" obligations under these purchase agreements (refer to Note 31).

(in thousands roubles)

20. Finance Lease Obligations (continued)

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, 2006 finance lease obligations denominated in foreign US dollars and Euro amounted to 29 and 67, respectively (2005 –38 and 67, respectively).

21. Accounts Payable, Accrued Expenses and Advances Received

As of December 31, 2006 and 2005 accounts payable and other current liabilities comprised the following:

	2006	2005
Accounts payable for capital investments	**1,393,812**	894,119
Trade accounts payable	**1,008,794**	629,470
Advances received from subscribers	**473,331**	432,425
Salaries and wages	**819,400**	431,708
Other accounts payable	**275,380**	186,814
Total	**3,970,717**	2,574,536

Accounts payable for capital investments in the amount of 98,468 and 35,567 included in trade payables as of December 31, 2006 and 2005, respectively, are denominated mainly in Euro and US Dollars.

22. Taxes Payable

As of December 31, 2006 and 2005, taxes payable comprised the following:

	2006	2005
Value-added tax	**119,886**	630,331
Property tax	**131,828**	124,708
Personal income tax	**14,363**	16,161
Unified social tax	**47,594**	40,240
Other taxes	**8,328**	1,272
Total	**321,999**	812,712

23. Pensions and Other Post-employment Benefit Plans

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

The defined benefit pension plan provides old age retirement pension and disability pension. The plans provide for payment of retirement benefits starting from statutory retirement age, which is currently 55 for women and 60 for men. The benefits are based on a formula according to which the benefits depend on a number of parameters, including the relative pay of participants and their length of service in the Company at retirement.

(in thousands roubles)

23. Pensions and Other Post-employment Benefit Plans (continued)

Non-government pension fund Telecom-Soyuz, which is related to the Company (Note 33), maintains the defined benefit pension plan. The Company funds the pension plan on a pay-as-you-go basis upon agreement with the pension fund.

The Company further provides other long-term employee benefits of a defined benefit nature such are lump-sum payments upon retirement, death, disability and jubilees to its active and former employees.

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

As of December 31, 2006 there were 39,156 working employees participating to the defined benefit pension plan of the Company and 14,117 pensioners eligible to the other post-employment benefit plans provided by the Company (as of December 31, 2005 – 47,342 and 12,635 respectively).

As of December 31, 2006 and 2005 the net liabilities of defined benefit pension and other post-employment benefit plans comprised the following:

	2006	**2005**
Present value of defined benefit obligation	**2,376,554**	1,919,361
Fair value of plan assets	–	(110,036)
Present value of unfunded obligation	**2,376,554**	1,809,325
Unrecognized past service cost	**(585,762)**	(408,381)
Unrecognized actuarial losses	**(503,497)**	(294,740)
Net pension liability in the balance sheet	**1,287,295**	1,106,204

As of December 31, 2006 the pension plan assets include Company’s promissory notes with a fair value of 369,594 (as of December 31, 2005 Company’s shares with a fair value of 2,009).

The amount of net expense for the defined benefit pension and other post-employment benefit plans recognized in 2006 and 2005 were as follows:

	2006	**2005**
Current service cost	**118,296**	89,185
Interest cost on benefit obligation	**133,696**	133,370
Expected return on plan assets	**(3,879)**	(13,756)
Net actuarial losses recognized in the year	**10,280**	32,690
Past service cost	**26,055**	196,644
Losses on curtailments and settlements	**42,035**	50,273
Net expense for the defined benefit plan	**326,483**	488,406
Actual return on plan assets	–	17,086

(in thousands roubles)

23. Pensions and Other Post-employment Benefit Plans (continued)

Changes in the present value of the defined benefit obligation in 2006 and 2005 were as follows:

	2006	2005
Defined benefit obligation at January 1	**1,919,361**	1,554,943
Interest cost on benefit obligation	**133,696**	133,370
Current service cost	**118,296**	89,185
Benefits paid	**(57,016)**	(55,216)
Liabilities extinguished on settlements	**(198,411)**	(327,384)
Past Service Cost	**203,435**	124,824
Actuarial losses on obligation	**257,193**	399,639
Defined benefit obligation at December 31	**2,376,554**	1,919,361

Changes in the fair value of plan assets in during 2006 and 2005 were as follows:

	2006	2005
Fair value of plan assets at January 1	**110,036**	201,866
Expected return	**3,879**	13,756
Actuarial gains/(losses)	**(3,879)**	3,330
Benefits paid	**(57,016)**	(55,215)
Assets distributed on settlement	**(198,411)**	(327,384)
Contributions by employer	**145,391**	273,683
Fair value of plan assets at December 31	**–**	110,036

The Company expects to contribute 118,300 to its defined benefit pension plans in 2007.

The major categories of plan assets as a percentage of the fair value of total plan assets are as follows:

	2006	2005
Russian equities	–	1.5%
Russian corporate bonds	–	22.7%
Russian government bonds	–	39.0%
Promissory notes	–	33.1%
Other assets	–	3.7%

(in thousands roubles)

23. Pensions and Other Post-employment Benefit Plans (continued)

As of December 31, 2006 and 2005 the principle actuarial assumptions of defined benefit pension and other post-employment benefit plans were as follows:

	2006	2005
Discount rate	**7%**	7%
Expected return on plan assets	**7.29%**	7.05%
Future salary increases	**9.20%**	8.15%
Relative pay increase (career progression)	**1%**	1%
Rate used for calculation of annuity value	**6%**	6%
Increase in financial support benefits	**5%**	5%
Staff turnover	**5%**	5%
Mortality tables (source of information)	**USSR 1985/86**	USSR 1985/86

The overall expected rate of return on assets is determined based on the market prices prevailing on that date and the structure of the plan assets portfolio. There has been change in the expected return on plan assets due some decrease in return on corporate promissory notes and decrease in their share in total plan assets in 2006.

Amounts for the current and previous four periods are as follows:

	2006	2005	2004	2003	2002
Present value of defined benefit obligation	**2,376,554**	1,919,361	1,554,943	1,445,121	1,123,467
Plan assets	**–**	(110,036)	(201,866)	(135,133)	(63,396)
(Deficit)/surplus	**2,376,554**	1,809,325	1,353,077	1,309,988	1,060,071
Experience adjustments on plan liabilities	**(134,368)**	(120,920)	4,275	(28,754)	9,953
Experience adjustments on plan assets	**(3,879)**	3,330	2,314	(4,500)	(1,150)

(in thousands roubles)

24. Revenues

Revenues for the year ended December 31, 2006 and 2005 comprised the following:

	2006	2005
Local telephone calls	**8,782,132**	7,482,458
Long distance telephone services – domestic	**–**	3,231,490
Intrazone telephone services	**3,117,053**	2,132,010
Cellular services	**3,717,754**	2,945,721
Installation and connection fees	**781,354**	1,443,219
New services	**1,935,142**	1,263,161
Revenues from operators	**4,146,281**	2,117,551
Long distance telephone services – international	**–**	787,839
Radio and TV broadcasting	**532,745**	501,134
Rent of telephone channels	**303,789**	388,615
Data transfer and telematic services	**226,335**	225,810
Documentary services	**41,855**	45,105
Other telecommunications services	**718,763**	746,478
Other revenues	**545,500**	445,642
Total	**24,848,703**	23,756,233

Following requirements of the Federal Law on Communications, new regulations became effective starting January 1, 2006. These regulations led to significant changes in rendering intrazone, domestic and international telephone services

Starting January 1, 2006 domestic and international long-distance telephone services are provided only by operators with respective licenses. According to the Company's license terms it ceased provision of DLD/ILD services and continued provision of intrazone telephone services.

In 2005 the Company did not present revenues from intrazone telephone services separately, as no separate tariffs were approved for this type of services. In 2005 revenues from intrazone call services in amount of 2,132,010 were presented combined with revenues from intercity calls services. For comparability purposes, the Company made the following reclassifications between types of revenues for 2005:

	As previously reported	Reclassifications	As restated
Long distance telephone services – domestic	6,147,983	(2,916,493)	3,231,490
Intrazone telephone services	–	2,132,010	2,132,010
Revenues from operators	1,154,194	963,357	2,117,551
New services	1,253,933	9,228	1,263,161
Other revenues	633,744	(188,102)	445,642

(in thousands roubles)

24. Revenues (continued)

The Company identifies revenue by the following major customer groups:

Customer groups	2006	2005
Residential customers	**13,519,951**	12,886,110
Corporate customers	**9,563,356**	9,200,435
Government customers	**1,765,396**	1,669,688
Total	**24,848,703**	23,756,233

25. Other Operating Expenses

Other operating expenses, net comprised the following:

	2006	2005
Lease of premises	**280,004**	319,376
Agency fees	**348,516**	280,780
Fire and other security services	**279,695**	230,974
Cost of goods sold	**156,477**	199,437
Universal service fund payments	**175,536**	165,558
Non-commercial partnership expenses	**139,983**	162,232
Advertising expenses	**245,870**	130,655
Audit and consulting fees	**227,926**	90,930
Charitable contributions	**143,035**	80,822
Insurance	**66,626**	72,910
Business travel expenses and representation costs	**88,240**	71,851
Bank services fees	**63,715**	55,528
Education expenses	**60,973**	52,218
Buildings maintenance	**63,065**	50,608
Auxiliary production services	**26,233**	36,984
Transportation services	**30,406**	28,792
Post services	**38,741**	26,848
Civil Defense	**9,726**	8,133
Other expenses	**68,670**	209,810
Total	**2,513,437**	2,274,446

Other expenses include expenses related to social expenditures, billing and cash collection services, other operating expenses.

(in thousands roubles)

26. Interest Expense, Net

Interest expense, net for the years ended December 31, 2006 and 2005 comprised the following:

	2006	2005
Interest income	**23,131**	22,942
Interest expense on loans	**(825,841)**	(632,854)
Interest expense accrued on finance leases	**(198,694)**	(225,890)
Interest expense on vendor financing	**(19,379)**	(7,730)
Total	**(1,020,783)**	(843,532)

27. Gain/(loss) on Sale of Subsidiaries, Associates and Other Investments

Gain from sale of subsidiaries, associates and other investments for the years ended December 31, 2006 and 2005 comprised the following:

	2006	2005
Gain on sale of CJSC "Samarasvyazinform"	–	21,703
Gain on sale of OJSC "Telesot"	–	6,851
Gain on sale of CJSC "Aktsionerny investitsionno-kommerchesky promyshlenno-stroitelny bank"	–	5,329
Gain on sale of CJSC "Sotovaya svyaz Mordovii"	–	4,805
Gain on sale of other investments	–	2,044
Other gain (losses) on investments	**(689)**	1,110
Loss on impairment of investments (see Note 10)	**(47,682)**	–
Total	**(48,371)**	41,842

28. Income Tax

Income tax charge for the years ended December 31, 2006 and 2005 comprised the following:

	2006	2005
Current income tax expense	**(1,228,456)**	(1,073,611)
Prior-year income tax adjustments	**153,503**	(5,776)
Deferred income tax expense	**(31,968)**	(312,234)
Total income tax for the year	**(1,106,921)**	(1,391,621)

(in thousands roubles)

28. Income Tax (continued)

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

	2006	2005
Profit before income tax and minority interest	**3,241,355**	3,895,645
Statutory income tax rate	**24%**	24%
Theoretical tax charge at statutory income tax rate	**(777,925)**	(934,955)
Increase (decrease) resulting from the effect of:		
Prior-year income tax adjustments	**(9,236)**	(5,776)
Non-taxable income	**103,301**	30,054
Reclassification of differences from permanent to temporary	**(49,118)**	–
Non-deductible expenses	**(373,943)**	(480,944)
Total income tax charge for the year at the effective rate of 34% (2005 - 36%)	**(1,106,921)**	(1,391,621)

The composition of deferred income tax assets and liabilities as of December 31, 2006 and 2005 was as follows:

	As at 31 December 2004	**Origination and reversal of temporary differences**	**As at 31 December 2005**	**Origination and reversal of temporary differences**	**Purchase of subsidiaries**	**As at 31 December 2006**
Deferred tax assets						
Accounts payable and accrued liabilities	115,588	5,531	121,119	79,399	–	200,518
Pension Liabilities	–	–		157,083		157,083
Accounts receivable	181,183	(111,690)	69,493	(35,597)	–	33,896
Loans and Borrowings	57,576	(28,152)	29,424	(46,624)	–	(17,200)
Finance Lease	–	26,547	26,547	(88,261)	–	(61,714)
Total deferred tax assets	**354,347**	**(107,764)**	**246,583**	**66,000**	**–**	**312,583**
Deferred tax liabilities						
Fixed Assets	(1,262,954)	(186,654)	(1,449,608)	68,676	13,905	(1,367,027)
Intangible assets	(70,780)	(24,403)	(95,183)	(164,796)	(100,671)	(360,650)
Inventories	(8,677)	8,164	(513)	1,474	–	961
Effect from investments valuation	(5,505)	(4,797)	(10,302)	(3,322)		(13,624)
Finance Lease	(3,220)	3,220	–	–	–	–
Total deferred tax liabilities	**(1,351,136)**	**(204,470)**	**(1,555,606)**	**(97,968)**	**(86,766)**	**(1,740,340)**
Deferred tax liabilities, net	**(996,789)**	**(312,234)**	**(1,309,023)**	**(31,968)**	**(86,766)**	**(1,427,757)**

(in thousands roubles)

28. Income Tax (continued)

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

Accordingly, the mentioned above differences were presented as follows in the balance as of December 31, 2006 and 2005:

	2006	2005
Deferred Tax Asset	**16,476**	27,049
Deferred Tax Liability	**(1,444,233)**	(1,336,072)
Deferred tax liability, net	**(1,427,757)**	(1,309,023)

The movement in deferred tax asset for the years ended December 31, 2006 and 2005 was as follows:

	2006	2005
Deferred tax asset, at 1 January	**27,049**	24,814
Deferred tax income (expense)	**(10,750)**	2,235
Share in deferred income tax of acquired companies	**177**	–
Net deferred tax asset, at 31 December	**16,476**	27,049

The movement in deferred tax liability for the years ended December 31, 2006 and 2005 was as follows:

	2006	2005
Deferred tax liability, at 1 January	**(1,336,072)**	(1,021,603)
Deferred tax expense	**(21,218)**	(314,469)
Share in deferred income tax of acquired companies	**(86,943)**	
Deferred tax liabilities of subsidiaries disposed	**–**	–
Deferred tax liability, at 31 December	**(1,444,233)**	(1,336,072)

29. Earnings per Share

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

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

	2006	2005
Profit for the year attributable to equity holders of the parent	**2,073,895**	2,465,295
Weighted average number of shares outstanding (thousands) (see Note 18)	**327,953**	327,953
Basic and diluted earnings per share attributable to equity holders of the parent, Russian Roubles	**6.32**	7.52

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

(in thousands roubles)

30. Dividends Declared for Distribution

Dividends declared in 2006 based on 2005 results:

Dividends on ordinary shares – 1.4744 Roubles per share	362,657
Dividends on preference shares – 2.7583 Roubles per share	226,135
Total	**588,792**

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.

31. Contingencies and Operating Risks

Operating Environment of the Company

Whilst there have been improvements in the Russian economic situation, such as an increase in gross domestic product and a reduced rate of inflation, Russia continues economic reforms and development of its legal, tax and regulatory frameworks as required by a market economy. The future stability of the Russian economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government.

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. 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 at December 31, 2006 management believes that its interpretation of the relevant legislation is appropriate and that the Company's tax, currency and customs positions will be sustained.

Changes in Industry Legislation

Changes in industry legislation which came into force during 2006 had significant impact on Company’s financial position and financial results. The amendments significantly changed Company’s relationships with interconnected operators and long-distance operators, including OJSC Rostelecom. During 2006 the Company carried out a campaign of renegotiation of contracts with Interconnected operators and long-distance operators. The purpose of contracts renegotiation was to bring terms of contracts in compliance with the new legal requirements.

31. Contingencies and Operating Risks (continued)

Changes in Industry Legislation (continued)

Due to the fact that the significant part of the new provisions became effective from January 1, 2006 at present these provisions almost have not been applied in practice. As a result possible disagreement in interpretations of the new provisions by the Company and the regulator may occur. The Company’s management believes that as at December 31, 2006 the respective Articles of the Law are interpreted correctly and that existing uncertainty in interpretations of amended provisions and new regulatory acts will not have significant impact on Company’s financial position and financial results in subsequent periods.

Legal Proceedings

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, there are no current legal proceedings or 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. Total amount of potential claims is assessed as 7,317.

Licenses

Substantially all of the Company’s revenues are derived from operations conducted pursuant to licenses granted by the Russian Government. These licenses expire in various years ranging from 2007 to 2012. Suspension or termination of the Company’s main licenses or any failure to renew any or all of these main licenses could have a material adverse effect on the financial position and operations of the Company.

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

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

Insurance Coverage

During 2006, 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.

(in thousands roubles)

31. Contingencies and Operating Risks (continued)

Guarantees Issued

The Company mainly guaranteed credit line facilities provided by Sberbank to OJSC “RTC-Leasing”, a lessor of telecommunication equipment, as of December 31, 2006. The total guarantees issued amounted to 2,587,070 (2005 –2,241,045). Management believes that the likelihood of material payments being required under these agreements is remote.

32. Contractual Commitments

Operating Lease Obligations

Operating lease obligations as at 31 December are as follows:

	2006	2005
Within one year	**60,330**	45,348
After one year but not more than five years	**70,382**	16,213
More than five years	**257,471**	94,945
Total	**388,183**	156,506

Amount of operating Lease expenses included in line Other operating expenses of Consolidated Statement of Operation amounted in 2006 to 280,004 (2005 – 319,376).

Capital Investments

As of December 31, 2006 the Company has commitments for capital investments into modernization and expansion of its network in the amount of 2,319,979 (2005 – 40), including capital investments for provision of the universal service in amount of 2,237,900.

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, 2006 are detailed below.

(in thousands roubles)

33. Balances and Transactions with Related Parties (continued)

Rendering Services

During the year ended December 31, 2006 and 2005 the Company rendered significant amount of services to the following related parties:

Related party	Relationship	Type of sales	Price determination method	2006	2005
OJSC "Rostelecom"	Controlled by OJSC “Svyazinvest”	Telecommunication services	Regulated tariff	**2,815,260**	845,405
CJSC "Samara telecom"	Associate company	Telecommunication services, rent	Arms’ length terms	**49,062**	32,832
LLC "Rossvyazinform"	Associate company	Logistics support	Arms’ length terms	**20,097**	14,764
CJSC "Rostelegraph"	Controlled by OJSC “Svyazinvest”	Telecommunication services	Arms’ length terms	**14,929**	6,885

Purchases

During the year ended December 31, 2006 and 2005 the following related parties rendered significant amount of services to the Company:

Related party	Relationship	Type of purchases	Price determination method	2006	2005
OJSC "RTComm.RU"	Controlled by OJSC “Svyazinvest”	Traffic transmission	Regulated tariff	**341,315**	225,608
NPF Telecom-Soyuz	Controlled by OJSC “Svyazinvest”	Pensions	Arms’ length terms	**241,428**	262,380
OJSC "Svyazinvest"	Parent company	Dividends	Based on decision of Shareholders’ meeting	**183,760**	174,733
Non-Commercial Partnership Centre for Research of Problems in Development of Telecommunications	Controlled by OJSC “Svyazinvest”	Agency agreement	Arms’ length terms	**148,369**	162,093
OJSC "Rostelecom”	Controlled by OJSC “Svyazinvest”	Telecommunication services	Regulated tariff	**130,126**	1,939,383
OJSC AKB "Svyaz-Bank"	Significant influence	Bank services	Arms’ length terms	**50,092**	791
CJSC "Samara Telecom"	Associate company	Telecommunication services, rent of premises	Arms’ length terms	**25,917**	10,891
CJSC "Rostelegraph"	Controlled by OJSC “Svyazinvest”	Telecommunication services	Arms’ length terms	**13,245**	7,104

(in thousands roubles)

33. Balances and Transactions with Related Parties (continued)

Accounts Receivable

As of December 31, 2006 and 2005 significant balances of accounts receivable from related parties were as follows:

Related party	Relationship	Type of accounts receivable	2006	2005
OJSC "Rostelecom”	Controlled by OJSC “Svyazinvest”	Telecommunication services	**355,550**	–
Non-Commercial Partnership Centre for Research of Problems in Development of Telecommunications	Controlled by OJSC “Svyazinvest”	Agency agreement	**106,878**	104,562
OJSC “Informatsionnye Tehnologii Svyazy” (OJSC “Svyazintech”)	Controlled by OJSC “Svyazinvest”	Software implementation	**44,538**	140,726
CJSC "Samara Telecom"	Associate company	Telecommunication services	**17,510**	2,767
OJSC "RTComm.RU"	Controlled by OJSC “Svyazinvest”	Traffic transmission	**9,668**	2,919
OJSC AKB "Svyaz-Bank"	Associate company	Bank services	**–**	84,333

Accounts Payable

As of December 31, 2006 and 2005 significant balances of accounts payable to related parties were as follows:

Related party	Relationship	Type of accounts payable	2006	2005
OJSC "Rostelecom	Controlled by OJSC “Svyazinvest”	Telecommunication services	**48,323**	108,146
CJSC "Samara Telecom"	Associate company	Telecommunication services	**25,610**	825
CJSC "Rostelegraph"	Controlled by OJSC “Svyazinvest”	Telecommunication services	**4,903**	554
OJSC "RTComm.RU"	Controlled by OJSC “Svyazinvest”	Traffic transmission	**2,123**	4,327

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 roubles)

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.

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 revenues associated with OJSC "Rostelecom" relate to traffic transmission services provided by the Company to OJSC "Rostelecom".

Borrowings from Related Parties

In 2006 the Company did not receive borrowings from related parties.

Borrowings to Related Parties

	2006	**2005**
As at 31 December previous year	**2,925**	5,925
Borrowings given	**3,000**	–
Borrowings repaid	**(1,000)**	(3,000)
As at 31 December current year	**4,925**	2,925

In 2004 the Company provided a loan to CJSC “"Nizhegorodskiy radiotelephone" in amount of 2,925 at 13% per annum. Interest income on the borrowing in 2006 amounted 380 (2005 – 380).

Transactions with Government Organizations

Government organizations are a significant element in the Company's customer base (see also Note 24), purchasing services both directly through numerous authorities and indirectly through their affiliates. The Company also renders services to other state-owned entities. Certain entities financed by the Government budget are users of the Company's network. These entities are generally charged lower tariffs as approved by the Federal Antimonopoly Agency than those charged to other customers. In addition, the Government may by law require the Company to provide certain services to the Government in connection with national security and the detection of crime.

Within the framework of operating activity, the Company carries out transactions with other entities, which are directly or indirectly controlled by the Government.

The Company does not perform its activities through the entities which are directly or indirectly controlled by the Government.

(in thousands roubles)

33. Balances and Transactions with Related Parties (continued)

Transactions with Government Organizations (continued)

The Company carries out transactions with the entities, directly or indirectly controlled by the Government, based on tariffs approved by the government bodies.

The entities, directly or indirectly controlled by the Government, do not affect transactions of the Company with other entities.

The Company is not allowed to disconnect certain entities, strategic for the Government, from public network by virtue of Government's decision. Tariffs for such entities are also established by the regulating body equal to those for commercial organizations.

As of December 31, 2006 and 2005, significant transactions between the Company, the Government and entities controlled by the Government were as follows:

	As at December 31, 2006		**2006**	
Type of transactions	**Assets**	**Liabilities**	**Revenues**	**Expenses**
Telecommunication services	–	–	**304,748**	–
Interconnection charges	–	–	**13,769**	–
Other operating expenses	–	–	**3,643**	–
Other revenues	–	–	**53,822**	–
Accounts receivables	**93,002**	–	–	–
Utilities expenses	–	–	–	**228,844**
Rent	–	–	–	**51,819**
Other expenses	–	–	–	**506,376**
Accounts payable	–	**84,815**	–	–
Loans and Borrowings	–	**743,915**	–	–
Interests	–	–	–	**167,635**

	As at December 31, 2005		**For 2005**	
Transaction	**Accounts receivable**	**Accounts payable**	**Revenues**	**Expenses**
Telecommunication services	–	–	278,059	–
Interconnection charges	–	–	11,473	–
Other operating expenses	–	–	3,997	–
Other revenues	–	–	50,691	–
Accounts receivables	43,350	–	–	–
Utilities expenses	–	–	–	148,117
Rent	–	–	–	22,713
Other expenses	–	–	–	554,089
Accounts payable	–	65,136	–	–
Loans and Borrowings	–	2,630,545	–	–
Interests	–	–	–	642,967

33. Balances and Transactions with Related Parties (continued)

Transactions with Government Organizations (continued)

Government subscribers and tariff compensation accounted for approximately 22% of gross trade accounts receivable as of December 31, 2006 (2005 – 44%). Amounts outstanding from government subscribers and debt of social security organizations with regard to compensation of expenses related to granting privileges to certain category of subscribers, as of December 31, 2006 amounted to 592,549 (2005 – 1,104,238).

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 is a member of the Partnership and has an agreement with it, under which it provides funding for industry research and common administrative activities on behalf of the Company and other 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, 2006 amounted to 148,369 (2005 – 162,232).

NPF Telecom-Soyuz

The Company has signed several centralized pension agreements with NPF Telecom-Soyuz (see Note 23). OJSC "Svyazinvest" holds the majority in the Board of Directors of NPF Telecom-Soyuz ("the Fund"). Payments from the Company to the Fund in 2006 amounted to 241,428 (2005 – 262,541).

Compensation to Key Management Personnel

Key management personnel comprise members of the Management Board and the Board of Directors of the Company, totaling 21 and 20 persons as of December 31, 2006 and 2005, respectively. Total compensation to key management personnel included in "Wages, salaries, other employee benefits and payroll taxes" in the statement of operations amounted to 39,260 and 32,136 for the years ended December 31, 2006 and 2005, respectively, and consists of remuneration for management services.

34. Financial Instruments and Risk management Objectives and Policies

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

Foreign Exchange Risk

Foreign exchange risk is the risk that fluctuations in exchange rates will adversely affect items in the Company's statement of operations, balance sheet and/or cash flows. Foreign currency denominated liabilities (see Notes 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.

(in thousands roubles)

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

Foreign Exchange Risk (continued)

As at December 31, 2006 the Company's liabilities in foreign currency were 933,032 (2005 – 1,081,990), including liabilities denominated in US dollars 474,547 (2005 – 402,922) and Euro and other currencies 458,485 (2005 – 679,068).

For the period from January 1, 2006 to December 31, 2006 exchange rate of the Russian Rouble to US Dollar increased by approximately 8.5% and exchange rate of the Russian Rouble to Euro decreased by approximately 1.5%. Possible decrease in the exchange rate of the Russian Rouble may lead to an increase in the amount of the Company's borrowings, as well as will cause difficulties in attraction of funds including funds required for refinancing of the existing debt.

The Central Bank of Russia set up strict rules referring to regulation of transactions in foreign currency with the purpose of stimulation of commercial use of Rouble. This regulation previews restrictions of Rouble conversion into hard currency and presents guidelines for conversion of revenue in hard currency into Roubles.

Interest Rate Risk

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

Interest rate risk relates to liabilities with floating rate denominated mainly in US Dollars and Euros. Floating rate for Company's liabilities is generally determined based on LIBOR, EURIBOR, Plafond-C rates.

The following table presents as of December 31, 2006 and 2005 the carrying amount by maturity of the Company's financial instruments that are exposed to interest rate risk:

As of December 31, 2006:	**< 1 year**	**1–5 years**	**> 5 years**	**Total**
Fixed rate				
Short-term obligations	**1,562,411**	–	–	**1,562,411**
Long-term obligations	**688,162**	**6,239,467**	**3,064,274**	**9,991,903**
Finance lease obligations	**797,152**	**596,296**	**220**	**1,393,668**
Loans given	**955**	**12,391**	–	**13,346**
Short-term deposits	–	–	–	–
Floating rate				
Short-term obligations	**20.296**	–	–	**20.296**
Long-term obligations	**19,019**	**194,096**	–	**213,115**
As of December 31, 2005:	**<1year**	**1–5years**	**>5years**	**Total**
Fixed rate				
Short-term obligations	602,246	–	–	602,246
Long-term obligations	2,588,730	5,412,754	2,168,871–	10,170,355
Finance lease obligations	359,300	727,768	–	1,087,068
Loans given	3,869	15,752	–	19,621
Short-term deposits	30,043	–	–	30,043
Floating rate				
Short-term obligations	81,495	–	–	81,495
Long-term obligations	111,142	8,041	–	119,183

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

Interest Rate Risk (continued)

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

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

Credit Risk

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

Financial assets, which are potentially subject to credit risk, consist principally of trade receivables. The carrying amount of accounts receivable, net of provision for impairment of receivables, represents the maximum amount exposed to credit risk. The Company has no significant concentrations of credit risk due to significance of the client base and regular monitoring procedures over customers’ and other debtors’ ability to pay debts. A part of accounts receivable is represented by debts of state and other non-commercial organizations. Recovery of these debts is influenced by political and economic factors, however, management believes that as of December 31, 2006 there is no significant risk of loss to the Company beyond the provision already recorded.

Financial instruments which can lead to credit risk generally presented by trade accounts receivables and other accounts receivables. Credit risk related to such assets has the limited nature in connection with significant client base of the Company and constant control procedures over borrowing capacity of the customers and other borrowers.

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.

Hedging

In 2006 the Company did not hedge neither foreign exchange risk nor interest risk.

Fair Value

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

(in thousands roubles)

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

Fair Value (continued)

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

	2006		2005	
Financial instruments	**Carrying amount**	**Fair value**	**Carrying amount**	**Fair value**
Financial assets				
Investments in associates	**129,103**	**129,103**	119,980	119,980
Long-term investments available for sale	**28,226**	**28,226**	24,910	24,910
Long-term accounts receivable	**22,671**	**22,671**	24,179	24,179
Long-term borrowings given	**12,391**	**12,391**	15,752	15,752
Accounts receivable	**1,872,300**	**1,872,300**	1,296,011	1,296,011
Cash and cash equivalents	**461,417**	**461,417**	1,338,713	1,338,713
Total	**2,526,108**	**2,526,108**	2,819,545	2,819,545
Financial liabilities				
Long-term bank loans	**788,702**	**788,702**	2,181,562	2,181,562
Long-term bonds	**8,262,264**	**8,319,836**	5,262,833	5,262,833
Long-term promissory notes	**266,040**	**266,040**	–	–
Long-term vendor financing	**180,830**	**180,830**	145,271	145,271
Long-term finance lease obligations	**596,516**	**596,516**	727,768	727,768
Accounts payable	**4,389,023**	**4,389,023**	3,571,889	3,571,889
Short-term bank loans	**1,512,243**	**1,512,243**	636,135	636,135
Short-term bonds	**55,969**	**56,370**	45,210	45,210
Short-term promissory notes	**14,108**	**14,108**	1,245	1,245
Short-term vendor financing	**387**	**387**	1,151	1,151
Current portion of long-term bank loans	**191,645**	**191,645**	1,015,884	1,015,884
Current portion of long-term bonds	–	–	999,243	1,007,243
Current portion of long-term promissory notes	**127,530**	**127,530**	260,420	260,420
Current portion of long-term vendor financing	**388,006**	**388,006**	424,325	424,325
Current portion of long-term finance lease obligations	**797,152**	**797,152**	359,300	359,300
Total	**17,570,415**	**17,628,388**	15,632,236	15,640,236

Carrying amounts of monetary assets and liabilities approximate their fair values; monetary assets and liabilities denominated in foreign currency are retranslated to Russian Rubles at exchange rate effective as at December 31, 2006.

Carrying amount of cash and cash equivalents approximates their fair value due to their short-term nature and minimal credit risks.

(in thousands roubles)

35. Subsequent Events

Purchase of Shares in OJSC “Tatincom-T”

The Company increased its share in OJSC “Tatincom-T” to 100% by purchase of 33.43% stake (2,285,783 shares) for 519,764 on April 13, 2007 and 16,57% stake (1,133,052 shares) for 327,224 (12,700 thousands US dollars) on April 20, 2007 from OJSC “Uralsvyazinform” and IFK “Solid”, respectively.

Dividends

The Board of Directors of the Company proposed the following distribution of profits to the Annual Shareholders’ meeting to be held on June 22, 2007:

Dividends on ordinary shares - 1,5776 Rubles per share	388,042
Dividend on preference shares - 2,9928 Roubles per share	245,360
Total	**633,402**

Dividends payable will be included in 2007 financial statements after approval by General Shareholders’ meeting.

Changes in Settlements with OJSC “Rostelecom” in 2007

Federal Law #119-FZ dated July 22, 2005 introduced amendments to the Tax Code effective from January 1, 2007. According to these amendments new rules of VAT offset for non-cash settlements (including settlements using mutual offsets) are set.

Starting from January 1, 2007 VAT may be offset only after actual payments of the tax to supplier. As a result settlements between OJSC “Rostelecom” and the Company changed with regard to cancellation of mutual offsets.

Tariffs for Telecommunication Services

The Degree of Federal Service on tariffs #278-c2 dated November 17, 2006 set new tariffs for local and interzone telephone services rendered by the Company and the amount of compensation surcharge that is included to tariffs for local and interzone calls initiation services at 0.44 Roubles per minute (2005 - 0.54 Roubles per minute). The Company envisages decrease in revenues from interzone calls initiation services due to decrease in compensation surcharge.

The following tariff plans are set for the Company:

- For subscribers - individuals: three obligatory tariff plans (with time-based, fixed and combined fee);
- For subscribers – legal entities: one obligatory tariff plan (with time-based fee).

Monthly payment for local telephone services is comprised of obligatory payment for the services “Provision of subscriber line” and “Provision of local telephone connection” (depending on type of fee).

35. Subsequent Events (continued)

Tariffs for Telecommunication Services (continued)

Tariff plan with fixed fee terms is primarily aimed at subscribers performing many calls. This tariff plan provides to subscribers unlimited volume of minutes per month for fixed monthly fee.

Tariff plan with time-based fee stipulates payments for each minute of calls, calls with duration of less than 6 seconds are not billed.

Tariff plan with combined fee stipulates base monthly number of minutes (360 – 380 minutes per month) for fixed fee and payments for each minute in excess of base limit at a decreased rate.

The above mentioned tariff plans are introduced in municipalities where technical capabilities of capturing calls duration data exists. If these capabilities are absent, subscribers are offered fixed fees at tariffs set by Federal Service on Tariffs which are effective from February 1, 2007.

Rendering of Universal Telecommunication Services

In 2006 the Company won the tenders for rendering universal telecommunication service using payphones in Privolzhskii region and started provision of the services from February 1st, 2007. During 1st quarter 2007 2,249 payphones were installed. By September 1, 2007 the Company plans to install and put in operation remaining 14,216 payphones. According to contract with Federal Communications Agency the Company will install 16,465 payphones for rendering Universal telecommunication services. The Company plans to invest 2.4 billion Roubles for implementation of this project.

New Provisions of the Federal Law on Communication

Federal Law #14-FZ dated February 9, 2007 introduced amendments to Federal Law #126-FZ "On Telecommunications" dated July 7, 2003. The amendments are effective from July, 2007 and comprise the following:

- mandatory assessment the conformity of a system communication network to the requirements in the sphere of communications. Such assessment shall be made in the form of an expert examination in compliance with the rules established by the Government of the Russian Federation.
- Registration of electric communication networks forming part of a general-use electric communication network in accordance with rules established by the Government of the Russian Federation;

The Company can not reliably measure the effects of these changes on the financial position and financial results of the Company as the procedures of the mandatory expertise and registration of the networks are not elaborated and approved by the Government.

Electric communication networks formed up before the date of this Federal Law's entry into force have to be registered in compliance with the requirements of amended Federal Law on Communications at latest on January 1, 2010.