

OJSC TATTELECOM

**International Financial Reporting Standards
Consolidated Financial Statements and
Independent Auditor's Report**

31 December 2012

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INDEPENDENT AUDITOR'S REPORT

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Note: These consolidated financial statements have been prepared in English and in Russian. However, in all matters of interpretation of information, views or opinions, the Russian version of the financial statements takes precedence over the English version.



Independent Auditor's Report

To the Shareholders and Board of Directors of OJSC Tatttelecom

We have audited the accompanying consolidated financial statements of OJSC Tatttelecom and its subsidiaries (the "Group"), which comprise the consolidated statement of financial position as at 31 December 2012 and the consolidated statements of comprehensive income, changes in equity and cash flows for 2012, and notes comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the fair presentation of these consolidated financial statements based on our audit. We conducted our audit in accordance with Russian Federal Auditing Standards and International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about 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 consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to express an opinion on the fair presentation of these consolidated financial statements.

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Note: These consolidated financial statements have been prepared in English and in Russian. However, in all matters of interpretation of information, views or opinions, the Russian version of the financial statements takes precedence over the English version.



Independent Auditor's Report (Continued)

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2012, and its financial performance and its cash flows for 2012 in accordance with International Financial Reporting Standards.

ZAO PricewaterhouseCoopers Audit

25 April 2013

Moscow, Russian Federation

M.N. Dyumina, Director (licence no. 01-000606),
ZAO PricewaterhouseCoopers Audit



Audited entity: OJSC Tattelecom

Certificate of inclusion in the Unified State Register of Legal Entities
№ 1031630213120 issued on 22 July 2003

Republic of Tatarstan, Kazan, N.Ershova str, 57

Independent auditor: ZAO PricewaterhouseCoopers Audit

State registration certificate № 008.890, issued by the Moscow
Registration Bureau on 28 February 1992

Certificate of inclusion in the Unified State Register of Legal Entities
№ 1027700148431 issued on 22 August 2002


Certificate of membership in self regulated organisation non-profit
partnership "Audit Chamber of Russia" № 870. ORNZ 10201003683
in the register of auditors and audit organizations

OJSC TATTELECOM
CONSOLIDATED STATEMENT OF FINANCIAL POSITION
(in thousands of Russian Roubles)

	Note	31 December	
		2012	2011
ASSETS			
Non-current assets			
Property, plant and equipment	9	10,374,081	10,517,726
Intangible assets	10	282,400	182,317
Financial investments	11	137,349	121,399
Other non-current assets	12	177,892	209,744
Total non-current assets		10,971,722	11,031,186
Current assets			
Inventory	13	221,604	195,807
Accounts receivable	14	896,426	782,061
Advances paid and prepaid expenses	15	131,146	110,591
Prepaid income tax		25,885	25,752
Prepaid taxes, other than income tax		12,517	27,264
Financial investments	11	31,160	28,142
Cash and cash equivalents	16	185,973	37,351
Total current assets		1,504,711	1,206,968
TOTAL ASSETS		12,476,433	12,238,154
EQUITY			
Ordinary shares	17	2,104,799	2,104,799
Treasury shares	17	(89,930)	(89,930)
Revaluation reserve for available for sale investments	11	3,373	(1,711)
Additional paid-in capital	17	232,275	232,275
Retained earnings		5,707,746	5,117,766
TOTAL EQUITY		7,958,263	7,363,199
LIABILITIES			
Non-current liabilities			
Long-term borrowings	18	525,152	1,614,458
Non-current finance lease liabilities		2,240	1,265
Deferred income tax liabilities	19	605,854	564,642
Deferred revenue	20	77,006	62,123
Post-retirement benefit obligations	21	206,282	190,969
Other non-current liabilities		-	7,708
Total non-current liabilities		1,416,534	2,441,165
Current liabilities			
Current portion of long-term borrowings	18	1,772,240	988,619
Current finance lease liabilities		7,277	4,000
Accounts payable and accrued liabilities	22	923,113	1,023,741
Taxes payable other than income tax	23	263,071	230,116
Deferred revenue, current portion	20	135,935	187,314
Total current liabilities		3,101,636	2,433,790
TOTAL LIABILITIES		4,518,170	4,874,955
TOTAL EQUITY AND LIABILITIES		12,476,433	12,238,154

Approved for issue and signed on 25 April 2013


L.N. Shafigoullin
General Director


M.N. Agafonova
Head of Finance

OJSC TATTELECOM
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
(in thousands of Russian Roubles)

	Note	For the year ended 31 December	
		2012	2011
Revenue	24	7,079,528	6,712,122
Operating expenses	25	(5,871,115)	(5,452,172)
Operating profit		1,208,413	1,259,950
Finance income		2,980	14,029
Finance costs	26	(203,389)	(210,431)
Foreign exchange gain /(loss)		6,326	(10,018)
Profit before income tax		1,014,330	1,053,530
Income tax expense	19	(215,954)	(227,777)
Profit for the year attributable to the owners of the Company		798,376	825,753
Other comprehensive income:			
Actuarial (loss)/gain, net of deferred taxes of 213 (2011: 3,269)	21, 19	(853)	13,076
Gain on revaluation of available-for-sale investments, net of deferred taxes of 1,017 (2011: 37)	11, 19	5,084	184
Total comprehensive income for the year attributable to the owners of the Company		802,607	839,013
Weighted average number of outstanding ordinary shares	17	20,386,378,080	20,386,378,080
Earnings per ordinary share, basic and diluted, in roubles per share		0.039	0.041

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

OJSC TATTELECOM
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
(in thousands of Russian Roubles)

	Note	Ordinary shares	Additional paid in capital	Revaluation reserve for available-for- sale investments	Treasury shares	Retained earnings	Total
Balance at							
31 December 2010		2,104,799	232,275	(1,895)	(81,892)	4,472,056	6,725,343
Total comprehensive income for the year		–	–	184	–	838,829	839,013
Dividends declared	17	–	–	–	–	(193,119)	(193,119)
Purchase of treasury shares		–	–	–	(8,038)	–	(8,038)
Balance at							
31 December 2011		2,104,799	232,275	(1,711)	(89,930)	5,117,766	7,363,199
Total comprehensive income for the year		–	–	5,084	–	797,523	802,607
Dividends declared	17	–	–	–	–	(207,543)	(207,543)
Balance at							
31 December 2012		2,104,799	232,275	3,373	(89,930)	5,707,746	7,958,263

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

OJSC TATTELECOM
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands of Russian Roubles)

	Note	For the year ended 31 December	
		2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES:			
Profit before income tax		1,014,330	1,053,530
Adjustments for:			
Depreciation of property, plant and equipment	9, 25	1,254,031	1,183,301
Amortisation of intangible assets	10, 25	141,389	92,776
Loss on disposal of property plant and equipment	25	89,424	69,564
Finance income		(2,980)	(14,029)
Finance costs	26	203,389	210,431
Loss on impairment of accounts receivable	14, 25	61,840	41,679
Foreign exchange (gain)/loss		(6,326)	10,018
Other non-cash operating costs		(35,058)	(24,898)
Operating cash flows before changes in working capital		2,720,039	2,622,372
Increase in accounts receivable		(212,264)	(162,515)
Increase in inventory		(19,600)	(42,767)
(Increase) / decrease in advances paid and prepaid expenses		(19,834)	74,085
Decrease in prepaid taxes, other than income tax		14,747	2,906
Decrease in accounts payable and accrued liabilities		(82,592)	(17,531)
Increase in taxes payable (other than income tax)		32,954	59,761
Decrease in deferred revenue		(66)	(253,785)
Changes in working capital		2,433,384	2,282,526
Income tax paid		(175,680)	(201,497)
Interest paid		(226,862)	(233,875)
Net cash from operating activities		2,030,842	1,847,154
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of property, plant and equipment		(1,220,452)	(1,677,790)
Purchase of intangible assets		(220,344)	(68,247)
Proceeds from sale of property, plant and equipment		78,279	46,829
Interest received		2,260	20,224
Purchases of investments		(7,708)	(24,277)
Acquisition of subsidiaries, net of cash acquired		–	(98,326)
Disposal of subsidiaries, net of cash disposed		11,000	7,000
Proceeds from repayment of investments		–	2,639
Net cash used in investment activities		(1,356,965)	(1,791,948)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Purchase of treasury shares		–	(8,038)
Repayment of bonds		(105,544)	–
Proceeds from borrowings		3,490,664	3,825,602
Repayment of borrowings		(3,686,361)	(3,994,337)
Finance lease payments		(16,943)	(17,481)
Dividends paid		(207,071)	(192,658)
Net cash used in financing activities		(525,255)	(386,912)
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS		148,622	(331,706)
CASH AND CASH EQUIVALENTS, beginning of the year		37,351	369,057
CASH AND CASH EQUIVALENTS, end of the year		185,973	37,351

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

1. OJSC TATTELECOM AND ITS OPERATIONS

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") for the year ended 31 December 2012 for OJSC Tatttelecom (hereinafter - "Tatttelecom" or "the Company") and its subsidiaries (together referred to as "the Group").

The Company was incorporated on 22 July 2003 as an open joint stock company and is domiciled in the Russian Federation.

The Company is the largest telecommunications operator in the Republic of Tatarstan. The Company operates through seven regional branches: Almetyevsky, Arsky, Buinsky, Nizhnekamsky, Chistopolsky, Kazansky and Naberezhno-Chelninsky zonal telecommunication nodes.

The Company's registered address and place of business: N. Ershova Street, 57, Kazan Republic of Tatarstan.

As of 31 December 2012 and 2011 the Company's major shareholders were as follows:

	<u>% of ownership</u>
OAo Svyazinvestneftehim	87.2%
Other	12.8%
Total	100.0%

The Company's ultimate parent and controlling party is the Government of the Republic of Tatarstan.

The Group consists of the Company and the following subsidiaries. All Group companies are incorporated under Russian law.

Subsidiary	% of ownership as of 31 December		Immediate parent
	2012	2011	
LLC Kamatel-K	100%	100%	OJSC Tatttelecom
LLC Elemte Invest	100%	100%	OJSC Tatttelecom
LLC Kamatel	100%	100%	OJSC Tatttelecom
LLC Kamatel-Yantel	100%	100%	OJSC Tatttelecom
LLC Volna	95%	95%	LLC Elemte Invest
LLC StroiRemKompania*	-	100%	LLC Elemte Invest

* The Group has sold its 100% interest in the subsidiary.

2. OPERATING ENVIRONMENT OF THE GROUP

The Russian economy displays certain characteristics of an emerging market. Russian tax, currency and customs legislations continue to develop and are subject to varying interpretation (Note 28).

The ongoing uncertainty and volatility of the financial markets, in particular in Europe, and other risks could have significant negative effects on the Russian financial and corporate sectors. The future economic development of the Russian Federation is dependent upon external factors and internal measures undertaken by the government to sustain growth, and to change the tax, legal and regulatory environment.

Management believes it is taking all necessary measures to support the sustainability and development of the Group's business in the current business and economic environment.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of preparation

The accompanying consolidated financial statements have been prepared under the historical cost convention as modified by the initial recognition at the fair value of financial instruments and the carrying amounts of equity items in existence at 31 December 2002, which include the adjustment for the effects of hyperinflation, calculated using conversion factors derived from the Russian Federation Consumer Price Index published by the Russian Statistics Agency.

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below.

The preparation of the consolidated financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 4.

Tattelecom and its subsidiaries maintain their accounts and prepare financial statements for regulatory purposes in accordance with Russian accounting legislation. The accompanying consolidated financial statements are based on statutory accounting records, which are maintained under historical cost convention. At each reporting date, the Company makes appropriate adjustments and reclassifications to its stand-alone statutory financial statements and those of its subsidiaries for the purpose of fair presentation in accordance with IFRS.

Functional and presentation currency

The Group's consolidated financial statements are measured in the currency prevailing in the economic environment in which the Group operates (functional currency). The functional and presentation currency of the Group is Russian rouble. All amounts in these consolidated financial statements are presented in thousands of Russian roubles unless otherwise stated.

Transactions denominated in foreign currencies are translated into the functional currency using the official exchange rates of the Central Bank of the Russian Federation ("CBRF") prevailing at the date of transactions. Exchange rate differences arising from such transactions and from translation of monetary assets and liabilities denominated in foreign currency at the closing exchange rate are recorded in the respective caption of the consolidated statement of comprehensive income.

The exchange rates of Russian rouble to US dollar ("USD") as of 31 December 2012 and 2011 were RUB 30.3727 and RUB 32.1961 to USD 1, respectively. The exchange rates of Russian rouble to euro ("EUR") as of 31 December 2012 and 2011 were RUB 40.2286 and RUB 41.6714 to EUR 1, respectively.

Consolidated financial statements

Subsidiaries are those companies in which the Group, directly or indirectly, has an interest of more than one half of the voting rights or otherwise has power to govern the financial and operating policies so as to obtain economic benefits. The existence and effect of potential voting rights that are presently exercisable or obtainable from presently convertible instruments are considered when assessing whether the Group controls another entity. Subsidiaries are consolidated from the date on which control is transferred to the Group (acquisition date) and are deconsolidated from the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries. The cost of an acquisition is measured at the fair value of the assets given up, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. The date of exchange is the acquisition date where a business combination is achieved in a single transaction, and is the date of each share purchase where a business combination is achieved in stages by successive share purchases.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Consolidated financial statements (continued)

The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized directly in profit or loss. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured at their fair values at the acquisition date, irrespective of the extent of any minority interest. Intercompany transactions, balances and unrealised gains on transactions between Group companies are eliminated.

Property, plant and equipment

Property, plant and equipment are stated at cost, less accumulated depreciation and provision for impairment, where required. If a unit of property, plant and equipment consists of several elements with different useful lives they are treated as separate fixed assets.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognized. All other repairs and maintenance are charged to profit or loss during the financial period in which they are incurred.

At each reporting date management assess whether there is any indication of impairment of property, plant and equipment. If any such indication exists, management estimates the recoverable amount, which is determined as the higher of the asset's fair value less costs to sell and its value in use. The carrying amount is reduced to the recoverable amount and the impairment loss is recognised in profit or loss.

Gains and losses on disposals determined by comparing proceeds with carrying amount are recognised in profit or loss.

Depreciation

Depreciation of property, plant and equipment is calculated using the straight-line method to allocate the cost less the residual values over their estimated useful lives, as follows:

	<u>Useful life in years</u>
Land	Not depreciated
Buildings	30 - 40
Machines and telecommunications equipment	10
Transmission devices	9 - 15
Transport vehicles	7
Office equipment and other	3 - 5

The residual value of an asset is the estimated amount that the Group would currently obtain from disposal of the asset less the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life. The residual value of an asset is nil if the Group expects to use the asset until the end of its physical life. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period. Assets under construction are not depreciated. Depreciation of these assets will begin when the related assets are ready to be placed in service.

Lease

The Company accounts for the leased property in accordance with the requirements of IAS 17, *Leases*. A lease is classified as a finance lease if the terms of the lease transfer substantially all risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Lease (continued)

For finance leases, the assets leased are capitalized in property, plant and equipment at the lower of the fair value of the leased asset and the present value of future minimum lease payments, at the inception of the lease in the lessee's statement of financial position. Amounts due within one year after the reporting date are classified as current liabilities and the remaining balance – as non-current liabilities.

Leased assets are depreciated over their useful lives as determined in accordance with the accounting policy or over the term of the finance lease, if shorter. Where there is reasonable certainty that the lessee will obtain ownership by the end of the finance lease term, the asset is depreciated over its useful life. Where it is possible that the assets received under finance lease agreements will be returned upon the end of the lease term, such assets are depreciated over: their useful lives or the lease term, whichever is shorter.

Where the Group is a lessee in a lease which does not transfer substantially all the risks and rewards incidental to ownership from the lessor to the Group, the total lease payments are charged to profit or loss on a straight-line basis over the lease term. The lease term is the non-cancellable period for which the lessee has contracted to lease the asset together with any further terms for which the lessee has the option to continue to lease the asset, with or without further payment, when at the inception of the lease it is reasonably certain that the lessee will exercise the option.

Intangible assets

Intangible assets primarily represent subscribers' base, software and licenses. Intangible assets are amortised using the straight-line method over their useful lives:

	<u>Useful life in years</u>
Software and licenses	1 - 10
Subscribers' base	5

If impaired, the carrying amount of intangible assets is written down to the higher of value in use and fair value less cost to sell.

Financial instruments – key measurement terms

Depending on their classification financial instruments are carried at fair value or amortised cost as described below.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Fair value is the current bid price for financial assets and current asking price for financial liabilities which are quoted in an active market. For assets and liabilities with offsetting market risks, the Group may use mid-market prices as a basis for establishing fair values for the offsetting risk positions, and apply the bid or asking price to the net open position as appropriate. A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange or other institution, and those prices represent actual and regularly occurring market transactions on an arm's length basis.

Amortised cost is the amount at which the financial instrument was recognised at initial recognition less any principal repayments, plus accrued interest, and for financial assets less any write-down for incurred impairment losses. Accrued interest includes amortisation of transaction costs deferred at initial recognition and of any premium or discount to maturity amount using the effective interest method. Accrued interest income and accrued interest expense, including both accrued coupon and amortised discount or premium (including fees deferred at origination, if any), are included in the carrying values of related items in the consolidated statement of financial position.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Financial instruments – key measurement terms (continued)

The effective interest method is a method of allocating interest income or interest expense over the relevant period so as to achieve a constant periodic rate of interest (effective interest rate) on the carrying amount. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts (excluding future credit losses) through the expected life of the financial instrument or a shorter period, if appropriate, to the net carrying amount of the financial instrument. The effective interest rate discounts cash flows of variable interest instruments to the next interest repricing date except for the premium or discount which reflects the credit spread over the floating rate specified in the instrument, or other variables that are not reset to market rates. Such premiums or discounts are amortised over the whole expected life of the instrument. The present value calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate.

Initial recognition of financial assets

Financial instruments at fair value through profit or loss are initially recorded at fair value. All other financial assets are initially recorded at fair value plus transaction costs. A gain or loss on initial recognition is only recorded if there is a difference between fair value and transaction price which can be evidenced by other observable current market transactions in the same instrument or by a valuation technique whose inputs include only data from observable markets. The Group uses discounted cash flow valuation techniques to determine the fair value of financial instruments that are not traded in an active market.

All purchases and sales of financial assets that require delivery within the time frame established by regulation or market convention (“regular way” purchases and sales) are recorded at trade date, which is the date on which the Group commits to deliver a financial asset. All other purchases are recognised when the entity becomes a party to the contractual provisions of the instrument.

Derecognition of financial assets

The Group derecognizes financial assets when (a) the assets are redeemed or the rights to cash flows from the assets otherwise expire or (b) the Group has transferred the rights to the cash flows from the financial assets or entered into a qualifying pass-through arrangement while (i) also transferring substantially all the risks and rewards of ownership of the assets or (ii) neither transferring nor retaining substantially all risks and rewards of ownership but not retaining control. Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without needing to impose restrictions on the sale.

Classification of financial assets

The Group classifies its financial assets into the following measurement categories: available-for-sale investments and loans and receivables.

Available-for-sale investments

Available-for-sale investments are carried at fair value. Interest income on available-for-sale debt securities is calculated using the effective interest method and recognised in profit or loss for the year as finance income. Dividends on available-for-sale equity instruments are recognised in profit or loss for the year as finance income when the Group’s right to receive payment is established and it is probable that the dividends will be collected. All other elements of changes in the fair value are recognised in other comprehensive income until the investment is derecognized or impaired at which time the cumulative gain or loss is reclassified from other comprehensive income to finance income in profit or loss for the year.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Classification of financial liabilities

Financial liabilities have the following measurement categories: (a) held for trading which also includes financial derivatives and (b) other financial liabilities. The Group classifies its financial liabilities as other financial liabilities. Other financial liabilities are carried at amortised cost.

Cash and cash equivalents

Cash and cash equivalents consist of cash in hand, deposits and highly liquid financial investments with initial maturities of three months or less, with low risks of a decrease in value.

Impairment of financial assets carried at amortised cost

Impairment losses are recognized in profit or loss when incurred as a result of one or more events (“loss events”) that occurred after the initial recognition of the financial asset and which have an impact on the amount or timing of the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. If the Group determines that no objective evidence exists that impairment was incurred for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. The primary factors that the Group considers in determining whether a financial asset is impaired are its overdue status and reliability of related collateral, if any.

If the terms of an impaired financial asset held at amortized cost are renegotiated or otherwise modified because of financial difficulties of the counterparty, impairment is measured using the original effective interest rate before the modification of terms.

Impairment losses are always recognised through an allowance account to write down the asset’s carrying amount to the present value of expected cash flows (which exclude future credit losses that have not been incurred) discounted at the original effective interest rate of the asset. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor’s credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account through profit or loss.

Inventory

Inventories comprise cables, spare parts, telephones, modems, IPTV set top boxes and are stated at the lower of the cost and net realisable value. Cost of inventory is determined based on actual cost of each inventory item. Net realizable value represents the estimated selling price determined under the ordinary business terms less marketing costs.

Advances paid and prepaid expenses (“prepayments”)

Advances paid and prepaid expenses (hereinafter – “prepayments”) are carried at cost less provision for impairment. A prepayment is classified as non-current when the goods or services relating to the prepayment are expected to be obtained after one year, or when the prepayment relates to an asset which will itself be classified as non-current upon initial recognition. Prepayments to acquire assets are transferred to the carrying amount of the asset once the Group has obtained control of the asset and it is probable that future economic benefits associated with the asset will flow to the Group. Other prepayments are written off to profit or loss when the goods or services relating to the prepayments are received. If there is an indication that the assets, goods or services relating to a prepayment will not be received, the carrying value of the prepayment is written down accordingly and a corresponding impairment loss is recognised in profit or loss for the year.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Pension plans and post-employment benefits

The Group operates a defined benefit pension plan. The plan is funded through payments to a non-governmental pension fund, NPF Volga-Capital, determined by periodic actuarial calculations. Typically defined benefit plans define an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and compensation. The liability recognized in the consolidated statement of financial position in respect of defined benefit pension plans is the present value of the defined benefit obligation at the end of the reporting period, together with adjustments for unrecognized past-service costs. The defined benefit obligation is calculated using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to other comprehensive income in the period in which they arise. Past service costs are recognized immediately in profit or loss.

Pension assets do not meet the definition of plan assets of IAS 19, *Employee Benefits*, as the Group has an unconditional right to redeem the value of these assets from the fund to the extent of the Group's contributions plus 80% of return on these assets less benefits paid. Pension assets are classified as non-current available-for-sale-investments under the caption "investment in pension fund" and are measured at fair value.

Value added tax

Output value added tax related to sales is payable to tax authorities on the earlier of: (a) collection of receivables from customers or (b) delivery of goods or services to customers. Input VAT is generally recoverable against output VAT upon receipt of the VAT invoice. The tax authorities permit the settlement of VAT on a net basis. VAT related to sales and purchases is recognised in the consolidated statement of financial position on a gross basis and disclosed separately as an asset and liability. Where a provision has been made for impairment of receivables, impairment loss is recorded for the gross amount of the debtor, including VAT.

Income tax

Income taxes have been provided for in these consolidated financial statements in accordance with Russian legislation enacted or substantively enacted by the end of the reporting period. The income tax charge comprises current tax and deferred tax and is recognised in profit or loss for the year except if it is recognised in other comprehensive income or directly in equity because it relates to transactions that are also recognised, in the same or a different period, in other comprehensive income or directly in equity.

Current tax is the amount expected to be paid to, or recovered from, the tax authorities in respect of taxable profits or losses for the current and prior periods.

Deferred income tax is provided using the balance sheet liability method for tax loss carry forwards and temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. In accordance with the initial recognition exemption, deferred taxes are not recorded for temporary differences on initial recognition of an asset or a liability in a transaction other than a business combination if the transaction, when initially recorded, affects neither accounting nor taxable profit. Deferred tax liabilities are not recorded for temporary differences on initial recognition of goodwill and subsequently for goodwill which is not deductible for tax purposes. Deferred tax balances are measured at tax rates enacted or substantively enacted at the end of the reporting period which are expected to apply to the period when the temporary differences will reverse or the tax loss carry forwards will be utilised.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Income tax (continued)

The Group's uncertain tax positions are reassessed by management at the end of each reporting period. Liabilities are recorded for income tax positions that are determined by management as more likely than not to result in additional taxes being levied if the positions were to be challenged by the tax authorities. The assessment is based on the interpretation of tax laws that have been enacted or substantively enacted by the end of the reporting period and any known court or other rulings on such issues. Liabilities for penalties, interest and taxes other than on income are recognised based on management's best estimate of the expenditure required to settle the obligations at the end of the reporting period.

Revenue recognition

Revenue is recognized when the amount of the revenue can be reliably measured, and when it is probable that future economic benefits will flow to the Group. Revenue is measured at the fair value of consideration received or receivable and represents amounts due for goods sold and services provided in the normal course of business, net of any discounts and value added tax.

The Group earns service revenues from usage of its local telephone networks and facilities. The principal services rendered by the Group are as follows:

- Local telecommunications services;
- Internet access services;
- Intrazonal telecommunications services;
- Installation and connection services;
- Interconnection services;
- Lease of cable capacity;
- IP telephony, IPTV and cable TV services;
- Lease of telephone canalisation channels;
- Other revenues.

Local telecommunications services

Local telecommunications services include provision of local voice services to subscribers (urban and rural telephony). The services rendered relate to use by customers (e.g. call minutes), availability over time (e.g. monthly service charges) or other agreed calling plans. Revenue from local telephony services is recognised in the period in which services are used by subscribers.

Internet access services

Revenue from the provision of internet access is recognised in the period in which the services are rendered.

Intrazonal telecommunications services

Intrazonal telecommunication services include the following:

- Telephone connections between subscribers of fixed line telephone network within the territory of the Republic of Tatarstan;
- Telephone connections between subscribers of fixed line telephone network and subscribers of mobile communication network where subscriber numbers of the calling party and destination party are included in the numbering capacity within, respectively, geographically identifiable and geographically unidentifiable numbering areas assigned to the same constituent territory of the Russian Federation.

The volume of services provided depends on the connection time (per minute billing). Revenue from intrazonal telephone communication services is recognised in the period in which services are used by subscribers.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Revenue recognition (continued)

Installation and connection services

Installation and connection fees are included in deferred income and recognised in sales revenue over an average estimated period during which the subscriber uses the line.

Interconnection and traffic transmission services

Revenue from interconnection services is recognised in the period in which traffic is routed through the Group's networks.

Lease of cable capacity

The Group recognises revenue from the lease of local and zone communication channels in the period in which services are provided.

IP telephony, IPTV and cable TV services

The Group recognises revenue from IP telephony, IPTV and cable TV services in the period in which the services are rendered.

Lease of telephone canalisation channels

The Group recognises revenue from lease of telephone canalisation channels in the period in which the service is rendered.

Other revenues

Other revenues primarily consist of revenues from telegraph services, services under agency agreements, maintenance services and sales of goods and are recognized when services are rendered/goods are delivered.

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of assets that necessarily take a substantial time to get ready for intended use or sale (qualifying assets) are capitalised as part of the costs of those assets. Capitalization of borrowing costs continues up to the date when the assets are substantially ready for their use. The Group capitalises borrowing costs that could have been avoided if it had not made capital expenditure on qualifying assets. Borrowing costs capitalised are calculated at the Group's average funding cost (the weighted average interest cost is applied to the expenditures on the qualifying assets), except to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset. Where this occurs, actual borrowing costs incurred less any investment income on the temporary investment of those borrowings are capitalised. All other borrowing costs are recorded in the finance costs of the consolidated statement of comprehensive income in the period in which they are incurred.

Dividends

Dividends are recorded as a liability and deducted from equity in the period in which they are declared and approved.

Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction, net of tax, from the proceeds. Any excess of the fair value of consideration received over the par value of shares issued is recorded as share premium in equity.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Treasury shares

Where the Company or its subsidiaries purchase the Company's equity instruments, the consideration paid, including any directly attributable incremental costs, net of income taxes, is deducted from equity attributable to the Company's owners until the equity instruments are cancelled, reissued or disposed of. Where such shares are subsequently sold or reissued, any consideration received, net of any directly attributable incremental transaction costs and the related income tax effects, is included in equity attributable to the Company's owners.

Earnings per share

Basic earnings per share are determined by dividing the profit attributable to the Group's shareholders by the weighted average number of ordinary shares outstanding during the reporting period. For the purpose of calculating diluted earnings per share, profit or loss attributable to the shareholders of the Group, and the weighted average number of ordinary shares outstanding are adjusted for the effects of an assumed conversion of all potentially dilutive ordinary shares into ordinary shares.

Transactions with related parties

For the purposes of these consolidated financial statements, parties are considered to be related if the parties are under common control or one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions as defined by IAS 24, *Related Party Disclosures*. In considering related party relationships, attention is directed to the substance of the relationship, not merely the legal form.

4. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENT IN APPLYING ACCOUNTING POLICIES

The Group makes estimates and assumptions that affect the amounts recognised in the consolidated financial statements and the carrying amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on management's past experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Management also makes certain judgements, apart from those involving estimations, in the process of applying the accounting policies. Judgements that have the most significant effect on the amounts recognised in the consolidated financial statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities within the next financial year include:

Useful lives of property, plant and equipment

The estimation of the useful lives of property, plant and equipment is a matter of judgement based on the experience with similar assets. The future economic benefits embodied in the assets will be consumed principally through use. However, other factors, such as technical or commercial obsolescence and wear and tear, often result in the diminution of the economic benefits embodied in the assets. Management assesses the remaining useful lives in accordance with the current technical conditions of the assets and estimated period during which the assets are expected to earn benefits for the Group.

The following primary factors are considered: (a) expected usage of the assets; (b) expected physical wear and tear, which depends on operational factors and maintenance program; and (c) technical or commercial obsolescence arising from changes in market conditions. Had the estimated useful lives been 10% higher (lower) than management's estimates, the depreciation expenses would have decreased (increased) by 110,405 (2011: 108,113).

4. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENT IN APPLYING ACCOUNTING POLICIES (CONTINUED)

Impairment of accounts receivable

Provision for impairment of accounts receivable is based on the historical data related to collectability of accounts receivable and solvency analysis of the most significant debtors. If the financial condition of customers were to deteriorate, actual write-offs might be higher than expected.

Installation and connection fees

Installation and connection fees are non-refundable fees received at the time of the subscribers' connection to the Group's telecommunications network. Installation and connection services are not separable from other telecommunications services provided to the subscribers. Revenue from installation and connection services is deferred upon receipt of the fees and amortized to profit or loss over the estimated average fixed line subscription period. Management's estimate of an average subscription period is based on the historical data and is six years for residential subscribers and five years for commercial organizations (2011: six and five years, respectively). Had the estimated subscription period increased (decreased) by one year, for both types of subscribers, the Group's revenue from installation and connection fees would have decreased (increased) by 37,020 (2011: 67,267).

5. ADOPTION OF NEW OR REVISED STANDARDS AND INTERPRETATIONS

The following new standards and interpretations became effective for the Group from 1 January 2012:

Other revised standards and interpretations effective for the current period. The amendment to IAS 12 "Income taxes", which introduced a rebuttable presumption that an investment property carried at fair value is recovered entirely through sale, did not have an impact on these consolidated financial statements.

6. NEW ACCOUNTING PRONOUNCEMENTS

Certain new standards and interpretations have been issued that are mandatory for the annual periods beginning on or after 1 January 2013 or later, and which the Group has not early adopted.

The following new standards and interpretations are not expected to affect significantly the Group's consolidated financial statements after their adoption:

IFRS 10, Consolidated Financial Statements (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013), replaces all of the guidance on control and consolidation in IAS 27 "Consolidated and separate financial statements" and SIC-12 "Consolidation - special purpose entities".

IFRS 12, Disclosure of interest in other entities, (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013), that provides for new disclosures by entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity.

IFRS 13, Fair Value Measurement, (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013), that aimed at improving disclosures and providing consistency using the revised definition of the fair value.

Amendments to IAS 1, Presentation of Financial Statements (issued June 2011, effective for annual periods beginning on or after 1 July 2012), that aimed at changing the disclosure of items presented in other comprehensive income.

6. NEW ACCOUNTING PRONOUNCEMENTS (CONTINUED)

Amended IAS 19, Employee Benefits (issued in June 2011, effective for annual periods beginning on or after 1 January 2013), makes significant changes to the recognition and measurement of defined benefit pension expense and termination benefits, and to the disclosures for all employee benefits.

Disclosures – Offsetting Financial Assets and Financial Liabilities – Amendments to IFRS 7 (issued in December 2011 and effective for annual periods beginning on or after 1 January 2013). These amendments require disclosures that will enable users of an entity's financial statements to evaluate the effect or potential effect of netting arrangements, including rights of set-off.

Offsetting Financial Assets and Financial Liabilities – Amendments to IAS 32 (issued in December 2011 and effective for annual periods beginning on or after 1 January 2014). This amendment clarifies the wording "currently, has a legally enforceable right of set-off".

Improvements to International Financial Reporting Standards (issued in May 2012 and effective for annual periods beginning 1 January 2013). This amendment provides for the improvements of five standards.

Transition Guidance Amendments to IFRS 10, IFRS 11 and IFRS 12 (issued in June 2012 and effective for annual periods beginning on or after 1 January 2013). The amendments also provide additional transition relief in IFRS 10, IFRS 11 "Joint Arrangements" and IFRS 12 "Disclosure of Interests in Other Entities".

Moreover, the International Accounting Standards Board has issued other pronouncement not yet adopted in the Russian Federation:

IFRS 9, Financial Instruments Part I: Classification and Measurement. IFRS 9, issued in November 2009 and amended in 2010 and 2011, replaces those parts of IAS 39 relating to the classification and measurement of financial assets and financial liabilities: (i) change its effective date to annual periods beginning on or after 1 January 2015 and (ii) add transition disclosures. Financial assets should be classified based on two measurement categories: subsequently measured at fair value and subsequently measured at amortised cost. All equity instruments are to be measured subsequently at fair value. Equity instruments that are held for trading will be measured at fair value through profit or loss. For all other equity investments, an irrevocable election can be made at initial recognition, to recognise unrealised and realised fair value gains and losses through other comprehensive income rather than profit or loss. There is to be no recycling of fair value gains and losses to profit or loss. While adoption of IFRS 9 is mandatory from 1 January 2015, earlier adoption is permitted. The Group is considering the implications of the standard, the impact on the Group and the timing of its adoption by the Group.

7. SEGMENT INFORMATION

The Group has identified seven operating segments which are the Group's regional branches. The discrete financial information for the identified operating segments (i.e. revenue, net financial result) is available and regularly reviewed by the Group's corporate management team ("chief operating decision maker" or "CODM"). This financial information is derived from the Group's statutory accounting records.

All identified operating segments meet the aggregation criteria under the IFRS 8, *Operating segments*, as these segments share similar economic characteristics and also are similar in respect of the nature of provided services, types of customer and the methods used to provide the services. On these grounds, the Company's management considers the Group to be a single reportable segment.

Management believes that the disclosure of the segments' financial information reviewed by CODM and the reconciliation of this information with these consolidated financial statements are not required as it would not affect the decision making process of the users of these consolidated financial statements, nor would it contribute to a better evaluation of the nature and the financial effects of the Group's business activities. The Company makes entity-wide disclosures as required by IFRS 8. The information required for disclosure can be found in the respective notes below.

8. BALANCES AND TRANSACTIONS WITH RELATED PARTIES

During 2012, the Group has entered in the following significant transactions with the parties controlled by the Company's ultimate parent:

	<u>2012</u>	<u>2011</u>
Revenue	762,292	660,665
Operating expenses	287,705	274,300

The Group had the following significant balances due to/from related parties:

	<u>Note</u>	<u>2012</u>	<u>2011</u>
Accounts receivable		82,187	83,029
Financial investments	11	117,252	104,242
Accounts payable		79,236	58,418
Borrowings	18	341,788	258,668

In 2012 remuneration of the members of the Board of Directors and key management personnel amounted to 60,954 (2011: 42,701).

9. PROPERTY, PLANT AND EQUIPMENT

	Note	Land and buildings	Telecommunication equipment	Transmission devices	Vehicles	Office equipment and other	Construction in progress	Total
Cost as of 31 December 2010		1,483,415	5,680,262	6,163,493	193,619	241,885	600,902	14,363,576
Accumulated depreciation as of 31 December 2010		(173,193)	(1,744,187)	(1,839,314)	(110,983)	(190,779)	–	(4,058,456)
Carrying amount as of 31 December 2010		1,310,222	3,936,075	4,324,179	82,636	51,106	600,902	10,305,120
Additions		–	27,006	–	–	–	1,447,472	1,474,478
Acquisition through business combinations		3,083	2,266	32,375	–	98	–	37,822
Transfers		38,197	741,766	700,973	20,720	1,641	(1,503,297)	–
Reclassification of initial cost		(25)	8,752	(10,474)	1,875	(128)	–	–
Reclassification of accumulated depreciation		3	(3,490)	4,328	(973)	132	–	–
Disposals		(16,145)	(65,759)	(120,465)	(6,061)	(4,150)	(5,983)	(218,563)
Depreciation on disposals		3,029	27,929	61,839	4,011	5,362	–	102,170
Depreciation charge	25	(32,371)	(651,454)	(454,966)	(25,679)	(18,831)	–	(1,183,301)
Cost as of 31 December 2011		1,508,525	6,394,293	6,765,902	210,153	239,346	539,094	15,657,313
Accumulated depreciation as of 31 December 2011		(202,532)	(2,371,202)	(2,228,113)	(133,624)	(204,116)	–	(5,139,587)
Carrying amount as of 31 December 2011		1,305,993	4,023,091	4,537,789	76,529	35,230	539,094	10,517,726
Additions		–	22,894	–	–	–	1,255,195	1,278,089
Transfers		4,401	591,922	611,981	31,442	5,617	(1,245,363)	–
Reclassification of initial cost		–	(1,877)	(187)	–	2,064	–	–
Reclassification of accumulated depreciation		–	774	142	–	(916)	–	–
Disposals		(42,174)	(155,929)	(95,446)	(12,204)	(5,462)	(6,464)	(317,679)
Depreciation on disposals		6,862	77,608	49,972	10,267	5,267	–	149,976
Depreciation charge	25	(31,928)	(688,190)	(496,824)	(23,212)	(13,877)	–	(1,254,031)
Cost as of 31 December 2012		1,470,752	6,851,303	7,282,250	229,391	241,565	542,462	16,617,723
Accumulated depreciation as of 31 December 2012		(227,598)	(2,981,010)	(2,674,823)	(146,569)	(213,642)	–	(6,243,642)
Carrying amount as of 31 December 2012		1,243,154	3,870,293	4,607,427	82,822	27,923	542,462	10,374,081

As of 31 December 2012 no property, plant and equipment was pledged as collateral for borrowings (2011: 378,874).

The carrying amount of the property, plant and equipment held under finance leases amounted to 125,059 (2011: 145,604), including machines and telecommunication equipment of 59,119 (2011: 73,531), vehicles of 59,703 (2011: 61,100) and office equipment of 6,237 (2011: 10,973). Additions included capitalised borrowing costs of 22,894 (2011: 27,006). The capitalisation rate was 8.06% (2011: 7.7%).

10. INTANGIBLE ASSETS

	Note	Software and licenses	Subscribers' base	Total
Cost as of 31 December 2010		149,293	45,055	194,348
Accumulated amortisation as of 31 December 2010		(37,900)	(12,702)	(50,602)
Carrying amount as of 31 December 2010		111,393	32,353	143,746
Additions		74,140	–	74,140
Acquisitions through business combinations		–	57,207	57,207
Disposals		(51,024)	–	(51,024)
Amortisation on disposals		51,024	–	51,024
Amortisation expense	25	(75,184)	(17,592)	(92,776)
Cost as of 31 December 2011		172,409	102,262	274,671
Accumulated amortisation as of 31 December 2011		(62,060)	(30,294)	(92,354)
Carrying amount as of 31 December 2011		110,349	71,968	182,317
Additions		241,472	–	241,472
Disposals		(48,246)	–	(48,246)
Amortisation on disposals		48,246	–	48,246
Amortisation expense	25	(118,276)	(23,113)	(141,389)
Cost as of 31 December 2012		365,635	102,262	467,897
Accumulated amortisation as of 31 December 2012		(132,090)	(53,407)	(185,497)
Carrying amount as of 31 December 2012		233,545	48,855	282,400

11. FINANCIAL INVESTMENTS

	2012	2011
Available-for-sale investments, including non-current portion of 119,335 (2011: 106,321).	128,106	117,302
Loans to employees, including non-current portion of 18,014 (2011: 15,078).	33,553	25,389
Other short-term loans	6,850	6,850
Total	168,509	149,541
Less non-current portion	(137,349)	(121,399)
Total current portion	31,160	28,142

11. FINANCIAL INVESTMENTS (CONTINUED)

Available-for-sale investments include the following:

	Note	<u>2012</u>	<u>2011</u>
Investment in pension fund - unlisted equity securities	8	117,252	104,242
Listed equity securities		7,905	10,111
Other unlisted equity securities		2,949	2,949
Total		<u>128,106</u>	<u>117,302</u>

The changes in the fair value of the investment in pension fund were as follows:

	Note	<u>2012</u>	<u>2011</u>
Balance at beginning of the year		104,242	95,638
The Company's contributions to the fund		18,302	18,302
Amounts paid to the fund to settle pension obligations	21	(11,393)	(9,919)
Gain on revaluation of available-for-sale investments		6,101	221
Balance at end of the year		<u>117,252</u>	<u>104,242</u>

12. OTHER NON-CURRENT ASSETS

	<u>2012</u>	<u>2011</u>
Advances for the acquisition of non-current assets	186,652	218,504
Impairment provision	(8,760)	(8,760)
Total	<u>177,892</u>	<u>209,744</u>

13. INVENTORY

	<u>2012</u>	<u>2011</u>
Cables and spare parts for telecommunications equipment	119,412	90,502
Goods for sale	76,810	68,850
Other inventories	25,382	36,455
Total	<u>221,604</u>	<u>195,807</u>

14. ACCOUNTS RECEIVABLE

	<u>2012</u>	<u>2011</u>
Accounts receivable	999,656	930,848
Impairment provision	(103,230)	(148,787)
Total	<u>896,426</u>	<u>782,061</u>
By group of customer:	<u>2012</u>	<u>2011</u>
Commercial organisations, net of impairment provision of 54,883 (2011: 81,688).	396,352	378,606
Residential subscribers, net of impairment provision of 16,657 (2011: 47,235).	470,717	387,936
State organisations, net of impairment provision of 31,690 (2011: 19,864)	29,357	15,519
Total	<u>896,426</u>	<u>782,061</u>

14. ACCOUNTS RECEIVABLE (CONTINUED)

Movements in the provision for impairment of accounts receivable were as follows:

	Note	<u>2012</u>	<u>2011</u>
Balance at beginning of the year		148,787	156,677
Amounts written off during the year		(107,397)	(49,569)
Accrual of impairment provision	25	<u>61,840</u>	<u>41,679</u>
Balance at end of the year		<u>103,230</u>	<u>148,787</u>

Analysis by credit quality of accounts receivable was as follows:

	<u>2012</u>	<u>2011</u>
<i>Neither past due nor impaired – exposure to:</i>		
- Commercial organisations	301,438	320,976
- Residential subscribers	303,826	284,357
- State organisations	<u>21,605</u>	<u>17,710</u>
Total neither past due nor impaired	626,869	623,043
<i>Past due, not impaired:</i>		
- Less than 30 days overdue	87,108	73,154
- From 30 to 60 days overdue	34,711	28,621
- From 60 to 90 days overdue	21,588	18,140
- From 90 to 120 days overdue	13,926	9,861
- From 120 to 180 days overdue	21,956	18,215
- More than 180 days overdue	<u>90,268</u>	<u>11,027</u>
Total past due, not impaired	269,557	159,018
<i>Past due and impaired:</i>		
- More than 180 days overdue	<u>103,230</u>	<u>148,787</u>
Total past due and impaired	103,230	148,787
Impairment provision	<u>(103,230)</u>	<u>(148,787)</u>
Total	<u>896,426</u>	<u>782,061</u>

The individually impaired receivables mainly relate to debtors, which are in unexpectedly difficult economic situations. The Group has no significant concentrations of credit risk as the Group's customer base is highly diversified and management is monitoring customers' ability to settle their debts on a regular basis.

15. ADVANCES PAID AND PREPAID EXPENSES

	<u>2012</u>	<u>2011</u>
Advances paid	71,585	105,978
Prepaid expenses	<u>59,561</u>	<u>4,613</u>
Total	<u>131,146</u>	<u>110,591</u>

16. CASH AND CASH EQUIVALENTS

	<u>2012</u>	<u>2011</u>
Short-term deposits up to 3 months	142,000	–
Bank balances payable on demand	37,276	31,523
Cash on hand	6,697	5,828
Total	<u>185,973</u>	<u>37,351</u>

Based on Fitch’s national rating, the credit quality of the banks in which the Group held its cash and cash equivalents balances was as follows:

	<u>2012</u>	<u>2011</u>
AAA rated	143,675	1,721
AA- to AA+ rated	324	29,630
A+ rated	34,956	–
Unrated	321	172
Total	<u>179,276</u>	<u>31,523</u>

17. SHARE CAPITAL

	<u>Number of shares, in thousands</u>
At 31 December 2010	20,419,338
Treasury shares	(32,960)
At 31 December 2011 and 31 December 2012	<u>20,386,378</u>

The total authorized number of ordinary shares was 20,885,140 thousand (2011: 20,885,140 thousand) shares with par value of RUB 0.1 per share. The difference of 20,401 between the nominal and carrying values of the shares reflects the effect of hyperinflation using the conversion factors derived from the Russian Federation Consumer Price Index (“CPI”), published by the Russian State Committee on Statistics (“Goscomstat”).

Additional paid in capital of 232,275 represents contributions in the form of property, plant and equipment received by the Company from its ultimate parent.

In 2012, the Company declared dividends of RUB 0.01016 per share (2011: RUB 0.00944 per share), totalling 211,775 (2011: 196,767), including dividends on treasury shares of 4,231 (2011: 3,648) for the year ended 31 December 2011.

18. BORROWINGS

	<u>2012</u>	<u>2011</u>
Bank borrowings	2,297,392	2,496,125
Corporate bonds	–	106,952
Total	<u>2,297,392</u>	<u>2,603,077</u>
Less non-current portion	(525,152)	(1,614,458)
Total current portion	<u>1,772,240</u>	<u>988,619</u>

18. BORROWINGS (CONTINUED)

	Note	Loan currency	Maturity	2012		2011	
				Carrying value	contractual interest rate % p.a.	Carrying value	contractual interest rate % p.a.
UniCredit Bank		Roubles	2013	700,450	7.85	700,452	7.85
Avers		Roubles	2015	568,692	9.0	–	–
AB Devon Credit		Roubles	2014	283,992	7.5	484,481	7.5
Absolut Bank		Roubles	2014	265,067	7.5	401,726	7.5
AK BARS Bank	8	Roubles	2013	241,715	3.2-8.25	258,668	3.2-8.25
Alfa Bank		Roubles	2013	119,048	7.5	476,295	7.5
Sberbank	8	Roubles	2015	100,073	8.95	–	–
ROSBANK		Roubles	2013	18,355	8.46	73,418	8.46
ING Bank (Eurasia)		Euro	2012	–	–	101,002	LIBOR+1.7
Other borrowings		Roubles		–		83	
Total				<u>2,297,392</u>		<u>2,496,125</u>	

The amount of undrawn credit line facilities as of 31 December 2012 equals to 1,360,000 (2011: 282,119), including non-current portion 960,000 (2011: nil).

None of the bank loans are collateralized by property, plant and equipment as of 31 December 2012 (2011: 101,002) (Note 9).

At 31 December 2012, the Group was in breach of a covenant for a loan with an outstanding balance of 265,067, including the non-current portion of 97,222 which was classified as short-term.

19. INCOME TAXES

The Group's income tax expense comprised the following:

	2012	2011
Current income tax expense	175,546	175,803
Deferred income tax expense	40,408	51,974
Total	<u>215,954</u>	<u>227,777</u>

19. INCOME TAXES (CONTINUED)

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

	<u>2012</u>	<u>2011</u>
Profit before income tax	1,014,330	1,053,530
Theoretical income tax at statutory income tax rate of 20% (2011: 20%)	202,866	210,706
Adjustments for:		
Non-taxable income	(40,551)	(32,256)
Non deductible expenses	44,218	44,293
Other	9,421	5,034
Income tax expense	<u>215,954</u>	<u>227,777</u>

Differences between IFRS and statutory taxation regulations in Russian Federation give rise to temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and their tax bases. The tax effect of the movements in these temporary deductible/(taxable) differences is detailed below and is recorded at the rate of 20% (2011: 20%).

	<u>Balance at 31 December 2011</u>	<u>Charged /(credited) to profit or loss</u>	<u>Charged to other comprehensive income</u>	<u>Balance at 31 December 2012</u>
Property, plant and equipment	(648,275)	(1,204)	–	(649,479)
Accounts payable and accrued liabilities	72,803	(17,560)	–	55,243
Deferred revenue	29,959	(847)	–	29,112
Financial investments	(22,449)	(12,553)	(1,017)	(36,019)
Defined benefit pension obligations	38,194	2,849	213	41,256
Accounts receivable	(25,475)	(22,255)	–	(47,730)
Other	(9,399)	11,162	–	1,763
Net deferred tax liabilities	<u>(564,642)</u>	<u>(40,408)</u>	<u>(804)</u>	<u>(605,854)</u>

	<u>Balance at 31 December 2010</u>	<u>Charged /(credited) to profit or loss</u>	<u>Charged to other comprehensive income</u>	<u>Balance at 31 December 2011</u>
Property, plant and equipment	(679,683)	31,408	–	(648,275)
Accounts payable and accrued liabilities	59,681	13,122	–	72,803
Deferred revenue	109,974	(80,015)	–	29,959
Financial investments	(11,979)	(10,433)	(37)	(22,449)
Defined benefit pension obligations	38,460	3,003	(3,269)	38,194
Accounts receivable	(29,686)	4,211	–	(25,475)
Other	3,871	(13,270)	–	(9,399)
Net deferred tax liabilities	<u>(509,362)</u>	<u>(51,974)</u>	<u>(3,306)</u>	<u>(564,642)</u>

20. DEFERRED REVENUE

	<u>2012</u>	<u>2011</u>
Deferred revenue from installation and connection fees	145,558	177,041
Subscriber advances	67,383	72,396
Total	212,941	249,437
Less non-current portion	(77,006)	(62,123)
Total current portion	135,935	187,314

21. POST-RETIREMENT BENEFIT OBLIGATIONS

The Company operates defined benefit pension plan which is based on the employees' remuneration, age, length of service and the position in the Company. The plan is funded by the Company and the employees.

The amount of pension obligations reflected in the Company's consolidated statement of financial position was as follows:

	<u>2012</u>	<u>2011</u>
Present value of pension obligations	206,282	190,969

The movements in the defined benefit obligations were as follows:

	Note	<u>2012</u>	<u>2011</u>
Balance at beginning of the year		190,969	192,298
Current service cost		10,363	9,551
Interest cost		15,277	15,384
Amounts paid by the fund to settle pension obligations	11	(11,393)	(9,919)
Actuarial loss/(gain)		1,066	(16,345)
Balance at end of the year		206,282	190,969

The amounts recognized in profit or loss were as follows:

	<u>2012</u>	<u>2011</u>
Current service cost	10,363	9,551
Interest cost	15,277	15,384
Defined benefit plan expenses	25,640	24,935

Defined benefit plan expense is included in the other operating expenses.

Experience adjustments:

	<u>2012</u>	<u>2011</u>
Carrying value of pension obligations	206,282	190,969
Gains arising of experience adjustments on plan liabilities	(13,858)	(17,579)

The principal assumptions used were as follows:

	<u>2012</u>	<u>2011</u>
Discount rate	7%	8%
Future salary increase	8.5%	8.5%
Future benefits increase	8.5%	8.5%
Staff turnover	3%	3%
Average life expectancy of the plan participants from date of retirement	16 years	16 years

Management's estimate of contributions to the Fund which will be paid in 2013 is 18,302.

22. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

	<u>2012</u>	<u>2011</u>
Payables to employees	270,264	229,994
Payable for interconnection and traffic transmission services	199,831	216,161
Payable for construction services	189,937	93,844
Payable for non-current assets	158,387	364,065
Accrued liabilities	58,734	87,355
Dividends payable	2,011	8,902
Other payables	43,963	23,420
Total	<u>923,127</u>	<u>1,023,741</u>

23. TAXES PAYABLE OTHER THAN INCOME TAX

	<u>2012</u>	<u>2011</u>
VAT payable	161,827	138,788
Insurance contribution payable	42,567	33,775
Property tax payable	42,207	41,629
Other taxes payable	16,470	15,924
Total	<u>263,071</u>	<u>230,116</u>

24. REVENUE

	<u>2012</u>	<u>2011</u>
Local telecommunication services	2,191,880	2,190,525
Internet access services	2,119,345	1,812,110
Intrazonal telecommunication services	783,209	868,725
Interconnection and traffic transmission services	541,531	506,664
Lease of cable capacity	207,149	195,040
IPTV and IP telephony services	184,942	134,767
Lease of telephone canalisation channels	135,378	114,110
Cable television services	95,234	21,401
Installation and connection services	57,029	270,419
Other revenues	763,831	598,361
Total	<u>7,079,528</u>	<u>6,712,122</u>
By group of customer:	<u>2012</u>	<u>2011</u>
Residential subscribers	3,790,619	3,705,611
Commercial organizations	2,525,807	2,295,765
State organisations	763,102	710,746
Total	<u>7,079,528</u>	<u>6,712,122</u>

25. OPERATING EXPENSES

	Note	<u>2012</u>	<u>2011</u>
Payroll expenses, including applicable taxes		2,039,272	1,791,464
Depreciation of property, plant and equipment	9	1,254,031	1,183,301
Interconnection and traffic transmission charges		589,123	536,955
Materials, repairs and maintenance		368,890	364,208
Utilities		280,498	267,235
Subscribers' connection costs		202,622	228,480
Taxes, other than income tax		188,033	177,487
Amortisation of intangible assets	10	141,389	92,776
Rent expense		113,061	101,158
Invoice delivery and acceptance of payments		97,129	96,127
Loss on disposal of property plant and equipment		89,424	69,564
Advertising expenses		78,304	47,890
Loss on impairment of receivables	14	61,840	41,679
Content operators' charges		56,969	14,378
Reimbursement from the Universal Service Fund, net of the respective contributions		(91,582)	(78,278)
Other expenses		402,112	517,748
Total		<u>5,871,115</u>	<u>5,452,172</u>

In 2012 the Group incurred expenses totalling 160,649 (2011: 142,989) related to the provision of universal telecommunication services. These expenses were included in relevant operating expenses categories. The Group received reimbursement of the above expenses from the Federal Telecommunications Agency, which is reported in the reimbursement from the Universal Service Fund caption of the operating expenses above. The Group's contribution to the Universal Service Fund totalled 69,067 (2011: 64,711).

26. FINANCE COSTS

	<u>2012</u>	<u>2011</u>
Interest payable on loans and vendor financing	199,909	207,733
Interest expense on finance leases	3,480	2,698
Total	<u>203,389</u>	<u>210,431</u>

27. RISK MANAGEMENT

The risk management function within the Group is carried out in respect of financial risks, operational risks and legal risks. Financial risk comprises market risk (including currency risk and interest rate risk), credit risk and liquidity risk. The primary objectives of the financial risk management function are to establish risk limits, and then ensure that exposure to risks stays within these limits. The operational and legal risk management functions are intended to ensure proper functioning of internal policies and procedures to minimise these risks.

Credit risk

Credit risk is the risk that counterparty may fail to fulfil its obligations to the Group on a timely basis, which will cause the Group to incur losses. Availability of a diversified client base allows the Group to be independent from specific customers (the Group's receivables are distributed among a significant number of residential subscribers, commercial and state organisations).

The Group's maximum exposure to credit risk by class of assets is reflected in the carrying amounts of financial assets in the consolidated financial statements and amounts to 1,250,908 (2011: 968,953).

27. RISK MANAGEMENT (CONTINUED)*Liquidity risk*

Liquidity risk is the risk that the Group will not be able to settle all obligations as they become due. The Group has established a detailed budgeting and cash forecasting process to ensure that it has adequate cash available to meet its payment obligations. The maturity analysis of the Group's financial liabilities (based on undiscounted contractual cash outflows) as at 31 December 2012 was as follows:

	Note	Less than one year	From one year to five years	Total
Bank loans	18	1,772,240	525,152	2,297,392
Finance lease liabilities		8,949	2,626	11,575
Accounts payable and accrued liabilities	22	923,113	–	923,113
Total financial liabilities, total		2,704,302	527,778	3,232,080

The maturity analysis of the Group's financial liabilities (based on undiscounted contractual cash outflows) as at 31 December 2011 was as follows:

	Note	Less than one year	From one year to five years	Total
Bank loans	18	881,667	1,614,458	2,496,125
Corporate bonds	18	106,952	–	106,952
Other non-current liabilities		–	12,127	12,127
Finance lease liabilities		4,776	1,516	6,292
Accounts payable and accrued charges	22	1,023,741	–	1,023,741
Total financial liabilities, total		2,017,136	1,628,101	3,645,237

The Group manages its liquidity on a corporate-wide basis to ensure the funding is sufficient to meet Group's operational needs in liquidity.

Currency risk

In respect of currency risk, management sets limits on the level of exposure by currency and in total. The positions are monitored on a regular basis. Financial assets of the Group totalled 1,250,908 (2011: 968,953) are denominated in Russian roubles and therefore do not bear currency risk. The table below summarises the exposure of the Group's financial liabilities to foreign currency exchange rate risk:

	Note	2012			2011		
		US Dollar	Euro	Total	US Dollars	Euro	Total
Bank loans	18	–	–	–	–	101,002	101,002
Accounts payable and accrued liabilities		99,311	7,507	106,818	154,769	117,551	272,320
Financial liabilities denominated in foreign currencies		99,311	7,507	106,818	154,769	218,553	373,322

27. RISK MANAGEMENT (CONTINUED)

Currency risk (continued)

The following table presents sensitivities of equity and net profit to reasonably possible changes in exchange rates applied at the reporting date relative to the Group's functional currency, with all other variables held constant:

	<u>2012</u>	<u>2011</u>
US Dollar strengthening by 10%	(9,931)	(15,477)
US Dollar weakening by 10%	9,931	15,477
Euro strengthening by 10%	(751)	(21,855)
Euro weakening by 10%	751	21,855

The exposure was calculated only for monetary balances denominated in currencies other than the functional currency of the Group.

Interest rate risk

Interest rate risk is the risk that changes in market interest rates on financial instruments used by the Group may negatively impact the Group's financial results and cash flows.

The Group has an exposure to changes in interest rates primarily through its debt by changing their fair value (fixed rate debt) or their cash flows (variable rate debt). The Group does not have a formal procedure in place for management of interest risk and does not use any derivative financial instruments to manage the interest rate risk. The Group limits its interest rate risk exposure by maintaining an appropriate mix between fixed and floating rate borrowings. In cases where the change in the current market fixed or variable interest rates is considered significant management may consider refinancing a particular debt on more favourable interest rate terms.

Management assesses on a regular basis the Group's sensitivity to increase or decrease in the floating interest rate. An increase (decrease) of 1% would result in the Group's net profit decrease (increase) of 300 (2011: 1,403). Such sensitivity assessment is used for the Group's management reporting with respect to the interest rate risk and reflects the management's assessment of reasonably possible fluctuations of interest rates. The analysis was applied to loans and borrowings (financial liabilities) on the basis of the assumption that the debt outstanding as at the end of reporting period remains outstanding during the year.

Capital risk management

The Group manages its capital to ensure that it is able to continue as a going concern while maximising the return to the shareholders through the optimisation of the debt and equity balance. In order to achieve this goal, the Group undertakes actions aimed at minimisation of risks and costs associated with the future financing. The Group has different types of borrowings available for use in order to meet its needs in capital, such as bonds' issuance, long-term and short-term borrowings.

Though the Group does not establish any formal policies with respect to debt and equity ratio, the Group reviews its capital structure on a regular basis to determine the necessary measures in order to maintain a balanced structure of its capital. In such reviews the management considers the cost of capital and risks related to each category of capital. The Group's targeted net debt to equity ratio should not exceed 50%.

27. RISK MANAGEMENT (CONTINUED)

Capital risk management (continued)

The Group's debt to equity ratio was calculated as follows:

	Note	2012	2011
Borrowings	18	2,297,392	2,603,077
Less cash and cash equivalents	16	185,973	37,351
Net debt		2,111,419	2,565,726
Equity		7,958,263	7,363,199
Net debt to equity ratio, %		27	35

There were no changes to the Group's approach to capital management during the year.

The Group has a stated dividend policy that stipulates the distribution of at least 30% of the Company's statutory non-consolidated net profit. However, the dividend for a specific year is determined after taking into consideration future earnings, capital expenditure requirements, future business opportunities and the Group current financial position. Dividends are recommended by the Board of Directors and approved by the Company's shareholders.

28. COMMITMENTS AND CONTINGENCIES

Litigation

From time to time and in the normal course of business, claims against the Group may be received. On the basis of its own estimates management is of the opinion that no material losses will be incurred in respect of these claims. No litigation provisions were set up in these consolidated financial statements.

Tax contingencies

Russian tax legislation, which was enacted or substantively enacted at the end of the reporting period, is subject to varying interpretations when being applied to the transactions and activities of the Group. Consequently, tax positions taken by management and the formal documentation supporting the tax positions may be successfully challenged by the relevant authorities. Russian tax administration is gradually strengthening, including the fact that there is a higher risk of review of tax transactions without a clear business purpose or with tax non-compliant counterparties. 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.

The tax consequence of transactions for Russian taxation purposes is frequently determined by the form in which transactions are documented and the underlying accounting treatment prescribed by Russian Accounting Rules. Also, Russian legislation sets rigorous documentation requirements and even minor errors normally lead to disallowance of related expenses. Management has assessed, based on their interpretation of the relevant tax legislation, that the Group may be exposed to possible tax risks amounting to 226 498 (2011: 209,635). No provision has been recorded for these tax risks.

28. COMMITMENTS AND CONTINGENCIES (CONTINUED)

Capital expenditure commitments

As of 31 December 2012 the Group has contractual capital expenditure commitments in respect of property, plant and equipment totalling 17,648 (2011: nil), in respect of construction of property, plant and equipment totalling nil (2011: 128,266) and in respect of intangible assets of 29,250 thousand (2011: nil).

The Group has already allocated the necessary resources to cover these commitments. The Group believes that future net income and funding will be sufficient to cover this and any similar commitments.

29. SUBSEQUENT EVENTS

In March 2013, the Company signed a three year non-revolving credit line agreement with Avers bank for an amount of 700,000 with interest of 9.25% per annum.

M. N. Dyumina, Director, ZAO «PricewaterhouseCoopers Audit»

25 April 2013 года



36 (thirty six) pages are numbered, binded and sealed