Open Joint Stock Company
Far East Telecommunications Company

Consolidated Financial Statements

Year ended December 31, 2004

with Independent Auditor's Report

OJSC Far East Telecommunications Company

Consolidated Financial Statements

For the year ended December 31, 2004

Contents

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Independent Auditors' Report

To the Shareholders and Board of Directors of OJSC Far East Telecommunications Company

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

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

3. As described in Note 5 "Property, Plant and Equipment", the Company has transitioned to International Financial Reporting Standards (IFRS) at January 1, 2003 and applied an exemption in IFRS 1, "First-time Adoption of International Financial Reporting Standards", which permits an entity to measure property, plant, and equipment at the date of transition to IFRS at fair value and use that fair value as deemed cost. However, we were not able to satisfy ourselves as to (i) whether the carrying amounts of property, plant, and equipment as at January 1, 2003 are representative of fair value; (ii) resulting depreciation expense for the years presented and (iii) the respective deferred tax balances as of the reporting dates and deferred tax expense for the years presented.

4. In our opinion, except for the effects on the financial statements of such adjustments, if any, which might have been determined to be necessary had we been able to satisfy ourselves as to the matter referred to in paragraph 3 above, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2004, and the consolidated results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Ernst & Young Vneshaudit

July 6, 2005

OJSC Far East Telecommunications Company

Consolidated Balance Sheets as of December 31, 2004

(in thousands rubles)

	Notes	December 31, 2004	December 31, 2003
ASSETS			
Non-current assets:			
Property, plant and equipment	**5**	**10,144,826**	8,259,594
Intangible assets	**6**	**532,364**	256,910
Investments in associates	**7**	**26,303**	346,765
Long-term investments	**8**	**3,486**	9,557
Long-term employee loans	**9**	**25,305**	13,762
Long-term advances given	**10**	**137,748**	233,274
Total non-current assets		**10,870,032**	9,119,862
Current assets:			
Inventories	**11**	**436,563**	252,391
Accounts receivable	**12**	**632,049**	471,439
Short-term investments	**8**	**223,422**	3,215
Other current assets	**13**	**676,457**	448,786
Cash and cash equivalents	**14**	**129,210**	140,110
Total current assets		**2,097,701**	1,315,941
TOTAL ASSETS		**12,967,733**	10,435,803
SHAREHOLDERS' EQUITY AND LIABILITIES			
Shareholders' equity:			
Preference shares	**16**	**1,081,053**	769,364
Ordinary shares	**16**	**3,284,653**	2,328,839
Fair value reserve		**158,829**	2,381
Retained earnings		**2,165,392**	2,737,814
Total shareholders' equity		**6,689,927**	5,838,398
Minority interest	**17**	**–**	91
Non-current liabilities:			
Long-term borrowings	**18**	**513,219**	1,119,850
Finance lease obligations	**19**	**1,064,534**	607,743
Long term taxes payable		**8,327**	17,600
Pension obligations	**22**	**231,000**	182,000
Deferred revenue		**100,554**	99,415
Deferred income tax liability	**29**	**736,842**	825,837
Other non-current liabilities		**18,740**	18,400
Total non-current liabilities		**2,673,216**	2,870,845
Current liabilities:			
Accounts payable, accrued expenses and advances received	**20**	**1,462,204**	842,583
Payables to Rostelecom	**34**	**82,167**	76,700
Taxes payable	**21**	**330,016**	292,209
Dividends payable	**32**	**12,047**	10,940
Short-term borrowings	**18**	**120,373**	132,313
Current portion of long-term borrowings	**18**	**1,238,521**	124,320
Current portion of finance lease obligations	**19**	**343,262**	247,404
Provisions	**23**	**16,000**	–
Total current liabilities		**3,604,590**	1,726,469
Total shareholders' equity and liabilities		**12,967,733**	10,435,803

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

OJSC Far East Telecommunications Company

Consolidated Statement of Operations

for the year ended December 31, 2004

(in thousands rubles, except per share amounts)

	Notes	2004	2003
Revenues	**24**	**8,933,554**	6,862,539
Operating expenses			
Wages, salaries, other employee benefits and payroll taxes		**(3,776,030)**	(3,046,361)
Interconnection charges – domestic companies		**(1,611,463)**	(1,121,771)
Depreciation and amortization	**5, 6**	**(915,289)**	(708,475)
Materials, repairs and maintenance, utilities		**(871,787)**	(852,120)
Taxes other than income tax		**(144,943)**	(100,739)
Provision for impairment of receivables	**12**	**(121,633)**	(125,720)
Loss on disposal of property, plant, and equipment		**(25,163)**	(34,614)
Other operating expenses, net	**25**	**(893,719)**	(656,442)
Total operating expenses		**(8,360,027)**	(6,646,242)
Operating profit		**573,527**	216,297
Share of result of associates	**7**	**232,843**	217,747
Interest expense, net	**26**	**(283,338)**	(106,134)
Gain/(loss) from sales of subsidiary, associates and other investments	**27**	**584,215**	(508)
Foreign exchange gain/(loss), net		**7,070**	(10,038)
Profit before income tax and minority interest		**1,114,317**	317,364
Income tax	**28**	**(358,250)**	(144,699)
Profit before minority interest		**756,067**	172,665
Minority interest	**18**	**–**	(91)
Net profit		**756,067**	172,574
Basic and diluted earnings per share (Russian Rubles)	**29**	**5.97**	1.36

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

OJSC Far East Telecommunications Company

Consolidated Statement of Cash Flows

for the year ended December 31, 2004

(in thousands rubles)

	Notes	2004	2003
Cash flows from operating activities:			
Profit before income tax and minority interest		**1,114,317**	317,364
Adjustments for:			
Depreciation and amortization	**5, 6**	**915,289**	708,475
Provision for impairment of receivables	**11**	**121,633**	125,720
Provision for legal claim		**16,000**	–
Loss on disposal of property, plant, and equipment		**25,163**	34,614
Share of result of associates	**7**	**(232,843)**	(217,747)
(Gain)/loss from subsidiary, associates and other investments	**27**	**(584,215)**	508
Interest expense, net	**26**	**283,338**	106,134
Foreign exchange (loss)/gain, net		**(7,070)**	10,038
Other non-cash items		**27,820**	(11,536)
Operating cash flows before working capital changes		**1,679,432**	1,073,570
Increase in accounts receivable		**(283,625)**	(278,041)
Increase in other current assets		**(227,285)**	(66,681)
Increase in inventories		**(184,828)**	(12,390)
Increase in pension obligations		**49,000**	36,000
Increase in accounts payable and accrued expenses		**240,561**	110,245
Increase in taxes payable		**37,643**	23,423
Cash flows generated from operations		**1,310,898**	886,126
Interest paid		**(176,683)**	(53,059)
Income tax paid		**(586,714)**	(200,206)
Net cash flows from operating activities		**547,501**	632,861
Cash flows from investing activities:			
Purchase of property, plant and equipment		**(1,233,851)**	(927,523)
Purchase of intangible assets		**(83,703)**	(248,738)
Proceeds from sales of property, plant and equipment		**1,045**	3,023
Proceeds from sale of subsidiary		**3,275**	–
Proceeds from sale of associates and other financial assets		**1,156,020**	–
Loans given to employees and repayment received, net		**(21,891)**	(9,481)
Interest received		**1,721**	1,077
Dividends received		**10,700**	645
Net cash flows used in investing activities		**(166,684)**	(1,180,997)
Cash flows from financing activities:			
Proceeds from promissory notes issues		**148,000**	200,187
Repayment of promissory notes		**(234,706)**	–
Proceeds from borrowings		**1,040,308**	1,237,868
Repayment of borrowings		**(705,308)**	(1,273,864)
Proceeds from debt securities issued		**–**	1,000,000
Repayment of finance lease obligations		**(530,748)**	(232,586)
Repayment of vendor financing obligations		**(46,470)**	(294,324)
Repayment of other non-current liabilities		**(8,936)**	(5,113)
Dividends paid		**(53,857)**	(43,507)
Net cash flows (used in)/from financing activities		**(391,717)**	588,661
Net (decrease)/increase in cash and cash equivalents		**(10,900)**	40,525
Cash and cash equivalents at the beginning of the year		**140,110**	99,585
Cash and cash equivalents at the end of the year		**129,210**	140,110

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

OJSC Far East Telecommunications Company

Consolidated Statements of Changes in Shareholders' Equity

For the years ended of December 31, 2004

(in thousands rubles)

	Notes	Share capital		Retained earnings	Fair value reserve	Total equity
		Preference shares	Ordinary shares			
At December 31, 2002	**2**	769,364	2,328,839	2,612,948	–	5,711,151
Net income for the year		–	–	172,574	–	172,574
Change in the fair value of financial assets available-for-sale, net of deferred income tax		–	–	–	2,381	2,381
Dividends	**30**	–	–	(47,708)	–	(47,708)
At December 31, 2003		769,364	2,328,839	2,737,814	2,381	5,838,398
Net income for the year		**–**	**–**	**756,067**	**–**	**756,067**
Increase in share capital	**16**	**311,689**	**955,814**	**(1,267,503)**	**–**	**–**
Change in the fair value of financial assets available for sale, net of deferred income tax		**–**	**–**	**–**	**156,448**	**156,448**
Dividends	**30**	**–**	**–**	**(60,986)**	**–**	**(60,986)**
At December 31, 2004		**1,081,053**	**3,284,653**	**2,165,392**	**158,829**	**6,689,927**

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

1. General Information

Authorization of Accounts

The consolidated financial statements of OJSC Far East Telecommunications Company and its subsidiary – (hereinafter "the Company" or OJSC FETEC) for the year ended December 31, 2004 were authorized for issue by the General Director and the Chief Accountant of the Company on July 6, 2005.

The Company

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

Open joint-stock company Svyazinvest, a federal holding company controlled by the Russian Federation, owns 51% of the Company's ordinary shares as of December 31, 2004.

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

The average number of employees in the Company in 2004 and in 2003 was approximately 19 thousand persons.

The registered office of the Company is Russia, 690950, Vladivostok, Svetlanskaya st., 57

Tariff Setting

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

Liquidity and Going Concern

As of December 31, 2004, the Company's current liabilities exceeded its current assets by approximately 1,506,889 (2003 – 410,528). As a result, there may be some doubt about the Company's ability to attract further financing and to pay its existing debts as they fall due.

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

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

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

1. General Information (continued)

Liquidity and Going Concern (continued)

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

2. Basis of Presentation of the Financial Statements

Basis of Preparation

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

The Company has transitioned to IFRS at the beginning of the earliest period presented in these financial statements (January 1, 2003) using the provisions of IFRS 1, "First-time Adoption of International Financial Reporting Standards", which is effective for periods starting on or after January 1, 2004. IFRS 1 applies to first-time adopters of IFRS including companies that previously applied some, but not all IFRS, and disclosed this fact in its most recent previous financial statements. The Company's previous financial statements disclosed that management made certain estimates and assumptions to present the carrying value of fixed assets which did not comply with historical cost concept as defined by IAS 16, "Property, plant, and equipment". Further, the Company did not apply the provisions of IAS 19 "Employee benefits" and as such did not account for defined benefit obligations.

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 regarding employee benefits at the date of transition even if the corridor approach is used for latter actuarial gains and losses.

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

Accounting for the Effect of Inflation

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

(in thousands rubles)

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

Management Estimates

The preparation of financial statements requires management of the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The most significant estimates with regard to those financial statements relate to the valuation and useful lives of fixed assets, provision for impairment of receivables and deferred taxation, as discussed in Notes 5, 12 and 28.

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

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

	Shareholders' equity as at December 31, 2003	**Net profit for the year ended December 31, 2003**	**Shareholders' equity as at January 1, 2003**
Previous GAAP as reported	**6,047,573**	**195,922**	**5,901,653**
Interconnection charges accrual	67,218	16,997	50,221
Deferred tax correction	(120,652)	(4,079)	(116,573)
Other	22,753	–	18,078
Previous GAAP as restated	**6,016,892**	**208,840**	**5,853,379**
Accrual for defined benefit plan	(178,494)	(36,266)	(142,228)
International Financial Reporting Standards	**5,838,398**	**172,574**	**5,711,151**

The previous GAAP refers to the accounting standards used in the Company's prior year international financial statements, in which the Company applied some, but not all, IFRSs as described above.

As noted above, the company has taken the exemptions permitted under IFRS 1 which allows an entity to (i) measure property plant and equipment and intangible assets at fair value at the transition date and (ii) recognize all cumulative actuarial gains and losses regarding employee benefits at the date of transition even if the corridor approach is used for latter actuarial gains and losses. Management estimates that the carrying value of all of the Company's property, plant and equipment is broadly comparable to their fair values. However, management is engaging an independent appraiser to support these fair values and as a result, the reported carrying amount of property, plant and equipment may be adjusted.

3. Summary of Significant Accounting Policies

3.1 Principles of Consolidation

Subsidiaries

The consolidated financial statements include financial statements of subsidiaries, the entities in which the Company has an interest of more than one half of the voting rights, or otherwise has power to exercise control over its operations. Subsidiaries are consolidated from the date on which control is transferred to the Company and are no longer consolidated from the date that control ceases. All intercompany transactions, balances and unrealized gains on transactions between parent and/or subsidiary companies are eliminated. Unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Financial statements of OJSC Far East Telecommunications Company and its subsidiaries, based on which the consolidated financial statements are prepared, are based on unified accounting policy.

Investments in Associates

Associates are entities in which the Company generally owns between 20% and 50% of the voting rights, or is otherwise able to exercise significant influence, but which it does not control or jointly control. Investments in associates are accounted for by the equity method of accounting and are initially recognised at cost. 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 recognised in the statement of operations and its share of movements in reserves is recognised 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 recognise further losses, unless the Company is obligated to make further payments to, or on behalf of, the associate.

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

3.2 Investments

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

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

For investments that are actively traded in organized financial markets, fair value is determined by reference to Stock Exchange quoted market bid prices at the close of business on the balance sheet date. For investments where there is no quoted market price, fair value is determined by reference to the

Current market value of another instrument which is substantially the same or is calculated based on the expected cash flows of the underlying net asset base of the investment.

(in thousands rubles)

3. Summary of Significant Accounting Policies (continued)

3.3 Foreign Currency Transactions

The measurement and presentation currency of the Company is the Russian Ruble, 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).

Assets and liabilities settled in Rubles 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.

3.4 Property, Plant and Equipment

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

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

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

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

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

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

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

To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset, interest costs on such borrowings are capitalised, during the period of time that is required to complete and prepare the asset for its intended use. All other borrowing costs are expensed.

3. Summary of Significant Accounting Policies (continued)

3.4 Property, Plant and Equipment (continued)

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

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

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

3.5 Intangible Assets

Intangible assets, which comprise primarily software and licenses, are capitalized at cost.

Licenses and software are depreciated on a straight-line basis over the estimated useful life equal to the term of license or of the right to use the software. Useful life of such intangible assets is 2-20 years.

Where an indication of impairment exists, the carrying amount of any intangible asset, is assessed and, when impaired, the asset is written down immediately to its recoverable amount.

3.6 Inventories

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

Cost of inventory is determined on the weighted average basis.

3.7 Accounts Receivable

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

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

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

3. Summary of Significant Accounting Policies (continued)

3.8 Value-Added Tax

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

Value added tax recoverable

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

Value added tax payable

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

3.9 Cash and Cash Equivalents

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

3.10 Borrowings

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

3.11 Leases

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

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

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

3. Summary of Significant Accounting Policies (continued)

3.12 Pensions and Other Post-Employment Benefits

Unified social tax

Under provisions of the Russian legislation, social contributions are made through a unified social tax ("UST") calculated by the Company by the application of a regressive rate (from 35.6% to approximately 18%) to the annual gross remuneration of each employee. The Company allocates the UST to three social funds (state pension fund, social and medical insurance funds), where the rate of contributions to the pension fund vary from 28% to 14% depending on the annual gross salary of each employee.

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

Other pension plans and post-employment benefits

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

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

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

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

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

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

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

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

3. Summary of Significant Accounting Policies (continued)

3.13 Deferred Income Tax

Deferred tax assets and liabilities are calculated in respect of temporary differences using the liability method. Deferred income taxes are provided for all temporary differences arising between the tax base of assets and liabilities and their carrying values for financial reporting purposes, except where the deferred income tax arises from goodwill amortization or the initial recognition 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.

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.

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

Deferred income tax relating to items recognized directly in equity are recognized in equity and not in the statement of operations.

3.14 Provisions

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

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

3.15 Shareholders' Equity

Share capital

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

Dividends

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

3. Summary of Significant Accounting Policies (continued)

3.16 Revenue

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

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

Long distance calls (domestic and international)

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

Local telephone calls

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

Installation and connection fees

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

3. Summary of Significant Accounting Policies (continued)

3.16 Revenue (continued)

Documentary services

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

Cellular services

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

Radio and TV broadcasting

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

Data transfer and telematic services

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

New services

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

Rent of telephone channels

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

Services for national operators

Revenue from national service providers includes two different groups.

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

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

3. Summary of Significant Accounting Policies (continued)

3.16 Revenue (continued)

Services for national operators (continued)

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

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

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

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

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

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

Other telecommunication services

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

Other revenues

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

3. Summary of Significant Accounting Policies (continued)

3.17 Commitments

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

Significant commitments are disclosed.

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

3.18 Contingencies

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

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

(in thousands rubles)

4. Segment Information

	2004					2003				
	Fixed line	**Mobile**	**Other**	**Intercom-pany eliminations**	**Total for the Company**	**Fixed line**	**Mobile**	**Other**	**Intercom-pany eliminations**	**Total for the Company**
REVENUE										
Sales to third parties	**8,469,365**	**340,459**	**123,730**	**–**	**8,933,554**	6,493,861	234,476	134,202	–	6,862,539
Inter-segment sales										
Total revenue	**8,469,365**	**340,459**	**123,730**	**–**	**8,933,554**	6,493,861	234,476	134,202	–	6,862,539
GROSS PROFIT										
Segment result	**1,175,002**	**119,993**	**43,607**	**–**	**1,338,602**	653,396	70,089	40,115	–	763,600
Unallocated corporate expenses					**(765,075)**					(547,303)
Operating profit					**573,527**					219,297
Share of result of associates					**232,843**					217,747
Interest expense, net					**(283,338)**					(106,134)
Gain/(loss) from sales of subsidiaries, associates and other investments					**584,215**					(508)
Foreign exchange gain/(loss), net					**7,070**					(10,038)
Income tax					**(358,250)**					(144,699)
Minority interest					**–**					(91)
Net profit					**756,067**					172,574

(in thousands rubles)

4. Segment Information (continued)

	2004					**2003**				
	Fixed line	**Mobile**	**Other**	**Intercom-pany eliminations**	**Total for the Company**	**Fixed line**	**Mobile**	**Other**	**Intercom-pany eliminations**	**Total for the Company**
OTHER INFORMATION										
Segment assets	**11,257,985**	**452,558**	**164,469**	–	**11,875,012**	8,876,495	320,507	183,442	–	9,380,444
Investments in associates	–	–	–	–	**26,303**	–	–	–	–	346,765
Unallocated corporate assets	–	–	–	–	**1,066,418**	–	–	–	–	708,594
Consolidated total assets					**12,967,733**					10,435,803
Segment liabilities	**1,559,454**	**62,689**	**22,782**	–	**1,644,925**	963,970	34,807	19,921	–	1,018,698
Unallocated corporate liabilities	–	–	–	–	**4,632,881**	–	–	–	–	3,578,616
Consolidated total liabilities					**6,277,806**					4,597,314
Capital expenditure	**2,944,072**	**107,382**	**43,034**		**3,094,488**	1,797,876	53,399	34,214	–	1,885,489
Fixed assets	***2,671,827***	***107,382***	***43,034***		***2,822,243***	*1,549,137*	*53,399*	*34,214*	–	*1,636,750*
Intangible assets	***272,245***	–	–	–	***272,245***	*248,739*	–	–	–	*248,739*
Depreciation and amortization	**(866,507)**	**(34,825)**	**(13,957)**	–	**(915,289)**	(667,349)	(25,060)	(16,065)	–	(708,474)
Other non-cash expenses, excl. depreciation (bad dept expenses, impairment of assets)					**(148,785)**					(131,021)

(in thousands rubles)

4. Segment Information (continued)

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

Unallocated costs represent general and administration expenses and taxes other than income tax.

Segment assets consist primarily of property, plant and equipment, intangible assets, inventories, receivables, and operating cash, and exclude investments, deferred tax assets, and assets used for general Company's purposes.

Segment liabilities comprise operating liabilities and exclude items such as taxation, corporate borrowings, liabilities related to assets that are the subject of finance leases, deferred tax liabilities, and other liabilities pertaining to the Company as a whole.

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

5. Property, Plant and Equipment

	Land, buildings and constructions	Switches and transmission devices	Construction in progress and equipment for installation	Vehicles and other	Total
Cost					
At December 31, 2003	3,711,105	4,463,178	321,278	440,464	8,936,025
Additions	–	–	2,822,243	–	2,822,243
Disposals	(10,765)	(18,758)	(8,062)	(2,801)	(40,386)
Disposals due to sale of subsidiary	(9)	(2,231)	(114)	(235)	(2,589)
Transfers	780,430	1,286,632	(2,368,344)	301,282	–
At December 31, 2004	**4,480,761**	**5,728,821**	**767,001**	**738,710**	**11,715,293**
Accumulated depreciation					
At December 31, 2003	(151,162)	(417,253)	–	(108,016)	(676,431)
Charge for the year	(200,163)	(508,003)	–	(202,980)	(911,146)
Disposals	7,754	8,303	–	1,053	17,110
At December 31, 2004	**(343,571)**	**(916,953)**	**–**	**(309,943)**	**(1,570,467)**
Net book value as of December 31, 2003	3,559,943	4,045,925	321,278	332,448	8,259,594
Net book value as of December 31, 2004	**4,137,190**	**4,811,868**	**767,001**	**428,767**	**10,144,826**

The Company has applied an exemption permitted by IFRS 1 which allows an entity to measure property, plant, and equipment at the date of transition to IFRS at fair value and use that fair value as deemed cost. Management estimates that the carrying value of all of the Company's property, plant and equipment is broadly comparable to their fair values. However, management is engaging an independent appraiser to support these fair values and as a result, the reported carrying amount of property, plant and equipment may be adjusted.

(in thousands rubles)

5. Property, Plant and Equipment (continued)

The net book value of plant and equipment held under finance leases at December 31, 2004 is 1,577,665 (2003 – 1,155,271). Leased assets are pledged as security for the related finance lease obligations (see Note 19).

In 2004, the Company increased construction in progress by the amount of capitalized interest totaling 93,360 (2003 – 37,159). Capitalization rate in 2004 was 14%.

Bank borrowings are secured by properties with the carrying value as of December 31, 2004 of approximately 1,077,223 (2003 – 264,469) (see Note 18).

6. Intangible Assets

	Licenses	Software	Other	Total
Cost				
At December 31, 2003	3,490	262,904	224	266,618
Additions	1,067	280,656	47	281,770
Disposals	(324)	(3,947)	–	(4,271)
Disposals due to sale of subsidiary	–	–	(21)	(21)
At December 31, 2004	**4,233**	**539,613**	**250**	**544,096**
Accumulated amortization				
At December 31, 2003	(1,532)	(8,053)	(123)	(9,708)
Charge for the year	(1,021)	(3,104)	(19)	(4,144)
Disposals	296	1,824		2,120
At December 31, 2004	**(2,257)**	**(9,333)**	**(142)**	**(11,732)**
Net book value at December 31, 2003	1,958	254,851	101	256,910
Net book value at December 31, 2004	**1,976**	**530,280**	**108**	**532,364**

The majority of licenses are amortized over 5 years period.

Oracle E-Business Suite

As of December 31, 2004 software includes Oracle E-business Suite software with a gross book value of 315,176 (2003 – 242,161), including interest capitalized of 9,023 (2003 – nil). In accordance with the supply contract, the Company has been provided with non-exclusive licenses for 4,749 users of E-business Suite 2003 Professional among other license applications.

The Company will commence amortizing the value of this software from the date of its implementation over useful life of the licenses. Until then, the Company periodically tests this software for impairment.

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

Advances given to acquire Oracle E-Business Suite software in the amount of 41,023 are included in "Long-term advances given" (see Note 10).

(in thousands rubles)

6. Intangible Assets (continued)

Amdocs Billing Suite

As of December 31, 2004 software also includes Amdocs Billing Suite software with a gross book value of 188,341 (2003 – nil). This software was purchased for the purpose of the implementation of unified automated settlements system. The project of implementation of the unified automated settlements system is expected to last 4-5 years.

The Company's Board of Directors approved the purchase of Amdocs Billing Suite software on November 20, 2004.

Amdocs Billing Suite software was supplied in December 2004 by LLC IBM Eastern Europe/Asia, at which point the Company transferred its promissory notes with the face value of 232,787. Repayment of promissory notes issued is expected to be exercised by June 1, 2006.

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

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

7. Investments in Associates

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

		As of December 31, 2004		As of December 31, 2003	
Associate	**Main activity**	**Voting shares**	**Carrying value**	**Voting shares**	**Carrying value**
LLC Magalyaskom	Mobile services	**50%**	**17,839**	50%	18,289
CJSC TeleRossVladivostok	Telecommunication services	**50%**	**8,222**	50%	8,368
LLC Kamalyaskom	Mobile services	**50%**	**242**	50%	825
CJSC Primtelephone	Mobile services	–	–	50%	238,803
CJSC DBSS-900	Mobile services	–	–	40%	80,480
CJSC Khabarovsky Mobile Telephone	Mobile services	–	–	30%	–
Total			**26,303**		346,765

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

Disposal of shares in associates for 2004 is presented below:

Associate	**Main activity**	**Carrying value of associate**	**Sale/disposal of share in equity on the date of transaction, %**
CJSC Primtelephone	Mobile services	440,826	50%
CJSC DBSS-900	Mobile services	101,363	40%
CJSC Khabarovsky Mobile Telephone	Mobile services	–	30%
Total		**542,189**	

(in thousands rubles)

7. Investments in Associates (continued)

Share of income from CJSC Primtelephone and CJSC DVSS-900 for the period beginning January 1, 2004 to the date of disposal were 212,521 and 20,883, respectively.

CJSC Khabarovskiy Sotoviy Telephone reported accumulated losses in the amount of 50,060 and 45,385 as of the date of disposal and December 31, 2003, respectively. As the Company's share in accumulated losses of this associate exceeded the interest in the associate, the Company did not recognize further losses. The carrying amount of the associate as of the date of disposal was equal to zero.

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

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

	2004	2003
Investments in associates at January 1	**346,765**	129,018
Share of income net of income tax	**232,843**	217,747
Dividends received	**(11,116)**	–
Sale of investments in associates	**(542,189)**	–
Investments in associates at December 31	**26,303**	346,765

The carrying value of investments in associates shown in these consolidated financial statements is equivalent to the Company's share in the net assets of the associated company.

8. Investments

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

Company	2004 Ownership interest	2004 Carrying value	2003 Ownership interest	2003 Carrying value
Long-term investments				
OJSC Daltelecom International	–	–	6.40%	2,624
OJSC JSCB Primorye	–	–	8.20%	2,152
OJSC SEZ Nakhodka	**8.47%**	**1,101**	8.47%	1,101
OJSC Far East Commercial Bank Dalkombank	**1.40%**	**858**	1.40%	858
Sberbank	–	–	0.71%	759
OJSC JSCB Svyazbank	**0.44%**	**687**	5.40%	1,180
OJSC Imperial	**19.60%**	**240**	19.60%	240
Other	–	**600**	–	643
Total long-term investments		**3,486**		9,557
Short-term investments				
OJSC Daltelecom International	**6.40%**	**221,967**	–	–
Sberbank	**0.0005%**	**1,405**	–	–
OJSC KamAZ	**0.003%**	**41**	–	–
OJSC Kolimabank	**0.09%**	**9**	–	–
ZAO Amur Mobile Telephone	–	–	19.00%	3,215
Total short-term investments		**223,422**		3,215
Total investments available-for-sale		**226,908**		12,772

(in thousands rubles)

9. Long-Term Employee Loans

As of December 31, 2004 and 2003 long-term loans given to employees are carried at amortized cost using the effective interest rate of 16%.

10. Long-Term Advances Given

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

	2004	2003
Advances given for capital constructions	**96,725**	208,252
Acquisition of Oracle E-Business Suite software (Note 6)	**41,023**	25,022
Total	**137,748**	233,274

11. Inventories

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

	2004	2003
Cable, materials, fuel and spare parts for telecommunications equipment	**361,002**	195,433
Finished goods and goods for resale	**12,348**	10,771
Small tools and other inventories	**63,213**	47,102
Impairment reserve	**–**	(915)
Total	**436,563**	252,391

As of December 31, 2004 no inventories have been pledged as security for borrowings.

12. Accounts Receivable

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

	2004	2003
Trade receivables – telecommunication services	**997,155**	771,885
Trade receivables – other	**72,780**	43,785
Provision for impairment of receivables	**(437,886)**	(344,231)
Total	**632,049**	471,439

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

	2004	2003
Residential customers	**329,141**	210,997
Tariff compensation from the state budget	**324,023**	297,492
Corporate customers	**271,583**	172,536
Governmental customers	**72,408**	90,860
Total	**997,155**	771,885

(in thousands rubles)

12. Accounts Receivable (continued)

Prior to January 2005, telecommunication services provided to privileged customers, which are individuals that the government has agreed to provide certain benefits, was compensated 50% by the state budget and the other 50% paid by the privilege subscribers themselves. Article 47 of the Federal Law "On Telecommunications" No. 126-FZ dated July 7, 2003 is effective starting from 2005, which amends the rules on providing telecommunication services to privileges customers. Starting from January 2005 telecommunication customers with the right of privileges are obliged to pay for telecommunication services in full with the subsequent reimbursement of their expenses by the state budget. The provisions of this Law are applicable for the Company, except for two regional branches: Primorie and Magadan (see Note 35).

The state budget is still responsible to compensate the amounts due from privileged customers at December 31, 2004 in the amount of 324,023. The Company has made an assessment of the recoverability of these amounts and has accrued a provision for impairment of receivables of 309,698. The amount of the provision on the receivables from privileged customers at December 31, 2003 of 297,492 was 220,305.

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

	2004	**2003**
Balance at January 1	**344,231**	250,200
Provision for the year	**121,633**	125,720
Trade and other receivables write-off	**(27,697)**	(31,689)
Provision disposal due to sale of subsidiary	**(281)**	–
Balance at December 31	**437,886**	344,231

13. Other Current Assets

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

	2004	**2003**
VAT recoverable	**393,793**	180,211
Prepaid income tax	**126,249**	36,159
Prepayments and advance payments	**76,725**	117,560
Deferred expenses	**21,151**	45,666
Short-term loans given	**9,418**	7,603
Other prepaid taxes	**9,161**	10,077
Settlements with personnel	**5,793**	5,891
Other	**34,167**	52,845
Provision for impairment of other current assets	**–**	(7,226)
Total	**676,457**	448,786

The following summarizes the changes in the provision for impairment of other current assets:

	2004	**2003**
Balance at January 1	**7,226**	14,339
Recovery for the year	**(4,646)**	(7,113)
Other receivables writen-off	**(2,580)**	–
Balance at December 31	**–**	7,226

The recovery of provision for impairment of other current assets is included in other operating expenses, net.

(in thousands rubles)

14. Cash and Cash Equivalents

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

	2004	2003
Cash at bank and on hand	**128,964**	139,997
Corporate bank cards in rubles	**246**	113
Total	**129,210**	140,110

As of December 31, 2004 cash at bank and on hand includes 8 (2003 - 241) denominated in foreign currency.

15. Significant Non-Cash Transactions

A portion of the Company's revenue from services provided was settled through an exchange of services, which resulted in the netting of receivable and payable amounts with the Company:

	2004	2003
OJSC Rostelecom	**370,771**	143,173
CJSC Rostelegraph	**29,959**	17,220
OJSC Dalsvyazstroy	**17,611**	–
LLC Ekvant	**16,953**	14,721
LLC Dalsvyaz-Kurier	**15,683**	–
CJSC Sakhalin Telecom Mobile	**12,349**	12,165
OJSC Magadanenergo	**11,486**	–
LLC Sovintel	**7,658**	1,419
Other debtors and suppliers	**175,724**	254,007
Total revenue from non-cash transactions	**658,194**	442,705

In 2004 the Company purchased property, plant and equipment by vendor financing and finance lease in the amount of 84,918 and 817,964, respectively (2003 – nil and 835,965, respectively).

During 2004 the Company purchased Amdocs billing system for 188,341 and paid by promissory notes with maturity in 2005-2006.

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

16. Share Capital

As at December 31, 2004 and 2003 the authorised number of ordinary and preference shares were 95,581,421 and 31,168,901, respectively. All authorised shares have been issued and fully paid.

As of December 31, 2004 the par value and carrying value of ordinary and preference shares were as follows:

Type of share	Number of outstanding shares	Par value per one share	Total par value	Carrying value
Ordinary	95,581,421	20	1,911,628	3,284,653
Preference	31,168,901	20	623,378	1,081,053
Total			**2,535,006**	**4,365,706**

(in thousands rubles)

16. Share Capital (continued)

The difference between the total par value and the total carrying value of share capital represents the effects of inflation of periods prior to January 1, 2003.

As at December 31, 2003 the total par value and carrying value of share capital was 1,267,503 and 3,098,203, respectively. On February 24, 2004 the par value of the preference and ordinary shares was increased from 10 rubles to 20 rubles through capitalization of retained earnings. This resulted in an increase of the par value and carrying value of share capital to 2,535,006 and 4,365,706, respectively.

The ordinary shareholders, which represent 75% of the share capital, are entitled to one vote per share. Class A preference shares, which represent 25% of the share capital, give the holders the right to participate in general shareholders' meetings without voting rights except in instances where decisions are made in relation to reorganisation and liquidation of the Company, and where changes and amendments to the Company's charter which restrict the rights of preference shareholders are proposed.

The preference shares have no rights of redemption or conversion but carry non-cumulative dividends per share of 10% of Russian accounting net income for the year. Annual amount of dividends on class A preference shares may not be less than dividends on ordinary shares. As such, the preference shareholders share in earnings along with ordinary shareholders and thus the preference shares are considered participating shares for the purpose of the calculation of earnings per share. If the Company fails to pay dividends, or has no profits in any year, the preferred shareholders have the right to vote in the general shareholders' meeting.

In August 2001 the Company executed a depositary agreement with JP Morgan Chase Bank regarding placement of American Depositary Receipts (ADRs), Level 1. The issue was registered on August 22, 2001. The depositary agreement between the Company and JP Morgan Chase Bank was revised on August 16, 2002 in accordance with the reorganization. In accordance with the depositary agreement each ADR is equal to 30 ordinary shares of the Company. As of the end of 2004, 51,603 ADRs represented 1,548,090 deposited ordinary shares, which constituted 1.62% of total ordinary shares issued.

Dividends were declared in 2004 in respect of 2003 to holders of ordinary shares and preference shares of Ruble 0.40 per ordinary share (2003 – Ruble 0.31 per ordinary share) and Ruble 0.73 per preference share (2003 –Ruble 0.58 per preference share).

In accordance with the Russian legislation, dividends may only be declared to the shareholders of the Company from net income as shown in the Company's Russian statutory financial statements. The Company reported net income 666,652 and 154,272 in its statutory financial statements in 2004 and 2003, respectively.

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

	Ordinary shares		**Preference shares**		**Total**
	Number of shares	**%**	**Number of shares**	**%**	**Number of shares**
OJSC Svyazinvest	48,330,683	51%	–	–	48,330,683
Other legal entities	40,507,701	42%	20,923,235	67%	61,430,936
Individuals	6,743,037	7%	10,245,666	33%	16,988,703
Total	**95,581,421**	**100%**	**31,168,901**	**100%**	**126,750,322**

(in thousands rubles)

17. Minority Interest

During 2004 the Company sold its 60% subsidiary CJSC Sotovye Sety Birobidjana (a Russian legal entity). A gain from sale of shares in the subsidiary is presented in Note 27.

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

	2004	2003
Minority interest as of January 1	**91**	–
Minority interest in subsidiary	–	91
Minority interest in subsidiary disposed	**(91)**	–
Minority interest as of December 31	–	91

The Company has no other subsidiaries at December 31, 2004.

18. Borrowings

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

	Range of interest rate	2004	2003
Short-term borrowings			
Bank loans (Rubles)	10.5-16%	**100,000**	82,000
Interest payable		**20,373**	18,313
Promissory notes (Rubles)		–	32,000
Total short-term borrowings		**120,373**	132,313
Long-term borrowings			
Bank loans (Rubles)	10.5%-13%	**317,000**	–
Bonds (Rubles)	14.2%	**1,000,000**	1,000,000
Vendor financing	8-11%	**51,993**	31,748
Promissory notes	6.0%-8.5%	**382,747**	212,422
Total long-term borrowings		**1,751,740**	1,244,170
Less: Current portion of long-term borrowings		**(1,238,521)**	(124,320)
Total long-term borrowings, net of current portion		**513,219**	1,119,850

Vendor financing denominated in EURO is 51,992 (2003 – 27,158), which bears interest of 8% (2003 – 10-11%). Vendor financing denominated primarily in Yen was nil (2003 - 4,590).

As of December 31, 2004 bank loans are secured by property, plant and equipment with the carrying value of 1,077,223 (2003 – 264,469).

(in thousands rubles)

18. Borrowings (continued)

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

Maturity date	Bank loans	Bonds	Vendor financing	Promissory notes	Total
2005	–	1,000,000	22,000	216,521	1,238,521
2006	55,000	–	–	166,226	221,226
2007	262,000	–	29,993	–	291,993
Total	**317,000**	**1,000,000**	**51,993**	**382,747**	**1,751,740**

Bonds

On July 18, 2003, the Company issued of 1,000,000 interest-bearing bonds with par value of 1,000 Rubles each. The bonds mature in 3 years from the date of issuance (November 2006). Under the terms of the issuance, the bond-holders may exercise early redemption in November 2005. As of December 31, 2004 the total amount of bonds issued was reclassed to the current portion of long-term borrowings.

Coupon interest rate is as follows:

Coupon number	Start date of coupon period	Coupon interest, % per annum	Coupon maturity date
1	November 19, 2003	14.5	May 19, 2004
2	May 19, 2004	14.5	November 17, 2004
3	November 17, 2004	15	May 18, 2005
4	May 18, 2005	15	November 16, 2005
5	November 16, 2005	13	May17, 2006
6	May17, 2006	13	November 15, 2006

The interest obligation was discharged within the time period prescribed by Prospectus for bond issue.

19. Finance Lease Obligations

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

	2004		**2003**	
	Minimum lease payments	**Present value of payments**	**Minimum lease payments**	**Present value of payments**
Current portion	**623,454**	**343,262**	460,241	247,404
2 to 5 years	**1,482,325**	**1,063,904**	958,636	606,718
Over 5 years	**884**	**630**	1,850	1,025
Total minimum lease payments	**2,106,663**	**1,407,796**	1,420,727	855,147
Less amounts representing finance charges	**(698,867)**	**–**	(565,580)	–
Present value of minimum lease payments	**1,407,796**	**1,407,796**	855,147	855,147

(in thousands rubles)

19. Finance Lease Obligations (continued)

In 2004 and 2003, the Company's primary lessor was OJSC RTC-Leasing. In 2004, the effective interest rate on lease liabilities ranged from 20% to 35% per annum (2003 - from 20% to 40%).

OJSC RTC-Leasing purchases telecommunication equipment from domestic and foreign suppliers and provides such equipment to the Company under finance lease agreements. The Company's obligations under finance leases to OJSC RTC-Leasing as of December 31, 2004 amounted to 1,885,597 (2003 – 1,073,512) including 1,281,664 principal amount (2003 – 662,293) and 603,933 interest payable (2003 – 411,219).

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

As of December 31, 2004 finance lease obligations denominated in foreign currency, mainly US dollars, amounted to 3,641 (2003 – 53,140).

20. Accounts Payable, Accrued Expenses and Advances Received

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

	2004	2003
Accounts payable for capital investments	**514,049**	133,975
Salaries and wages	**492,833**	345,165
Advances received from subscribers	**242,409**	222,612
Trade accounts payable	**155,800**	108,200
Other accounts payable	**57,113**	32,631
Total	**1,462,204**	842,583

Other accounts payable include outstanding settlements with insurance providers, payments to Non-Commercial Partnership (Note 33) and other.

21. Taxes Payable

Current Taxes Payable

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

	2004	2003
Value added tax	**251,651**	177,343
Unified social tax	**29,693**	37,193
Property tax	**27,107**	20,399
Individual income tax	**16,865**	19,821
Income tax	**164**	–
Sales tax	**1**	20,952
Other taxes	**4,535**	16,501
Total	**330,016**	292,209

(in thousands rubles)

21. Taxes Payable (continued)

Current Taxes Payable (continued)

Included in value added tax payable is the amount of 157,114 (2003 - 113,493), which represents deferred value added tax, that is only payable to the tax authorities when the underlying receivable is recovered or written off.

Long-Term Taxes Payable

Long-term taxes payable comprise various taxes payable to the Russian Government which were previously past due and which have been restructured to be repaid over a period of up to 10 years following the application of Government Resolution No. 1002 dated September 3, 1999.

22. Pension Obligations

In addition to statutory pension benefits, the Company also contributes to post-employment benefit plans, which covers most of its employees. The Company participates in both defined contribution and defined benefit plans. In respect of the later, the Company applied the exemption permitted by IFRS 1 which allows an entity to recognize all cumulative actuarial gains and losses at the date of transition, even if the corridor approach is used for later actuarial gains and losses.

Defined Benefit Pension Plans

Most employees are covered by defined benefit pension plan. The defined benefit pension plan provides old age retirement pension and disability pension. The plans provide for payment of retirement benefits starting from statutory retirement age, which are currently 55 for women and 60 for men. The benefits are based on a formula specific to each branch of the Company. According to the formula the benefits depend on a number of parameters, including the relative pay of participants and their past service in the Company at retirement. The benefits do not vest until and are subject to the employee retiring from the Company on or after the above-mentioned ages.

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

The latest independent actuarial valuation of the Company’s pension and other post-employment and post-retirement benefits in accordance with IAS 19 was performed in May 2005.

There were 18,964 active employees participating to the defined benefit pension plan of the Company and 895 pensioners eligible to the post-employment and post-retirement benefits, as of December 31, 2004 (as of December 31, 2003 – 18,354 and 649 respectively).

As of December 31, 2004 and 2003 Company’s net liabilities on defined benefit pension plans comprised the following:

	2004	**2003**
Present value of defined benefit obligation	**696,000**	606,000
Fair value of plan assets	**(160,000)**	(102,000)
Present value of unfunded obligations	**536,000**	504,000
Unrecognised actuarial losses	**(30,000)**	(24,000)
Unrecognised past service cost	**(275,000)**	(298,000)
Net pension liability in the balance sheet	**231,000**	182,000

(in thousands rubles)

22. Pension Obligations (continued)

Defined Benefit Pension Plans (continued)

As of December 31, 2004 management estimated employees' average remaining working life at 15 years (2003 - 15 years).

The amount of net expense for defined benefit pension plans recognized in 2004 and 2003 is as follows:

	2004	2003
Service cost	**37,000**	26,000
Interest cost	**58,000**	44,000
Expected return on plan assets	**(11,000)**	(8,000)
Amortisation of past service cost – non-guaranteed potion	**23,000**	18,000
Net expense for the defined benefit pension plan	**107,000**	80,000

The amount of net expense for defined benefit pension plans is included in the consolidated statement of operations line "Wages, salaries, other benefits and payroll taxes".

The movements in the net liability for defined benefit pension plans in 2004 and 2003 were as follows:

	2004	2003
Net liability at January 1	**182,000**	146,000
Net expense for the year	**107,000**	80,000
Contributions	**(58,000)**	(44,000)
Net liability at December 31	**231,000**	182,000

As of December 31, 2004 and 2003 the principal actuarial assumptions used were as follows:

	2004	2003
Discount rate	**9.18%**	9.18%
Expected return on plan assets	**9.33%**	9.26%
Future salary increases	**9.18%**	9.18%
Relative pay increase (career progression)	**1.00%**	1.00%
Rate used for calculation of annuity value	**6.00%**	6.00%
Staff turnover	**2.25%**	2.25%
Mortality tables (source of information)	**year 1998**	year 1998

The movements in the net assets of defined benefit pension plans during 2004 and 2003 are characterized by the following factors:

	2004	2003
Fair value of plan assets at January 1	**102,000**	59,000
Actual return on plan assets	**14,000**	10,000
Employer contributions	**58,000**	44,000
Benefits Paid	**(14,000)**	(11,000)
Fair value of plan assets at December 31	**160,000**	102,000

(in thousands rubles)

22. Pension Obligations (continued)

Defined Benefit Pension Plans (continued)

Actual return on plan assets for 2004 was 11.29%.

As of December 31, 2004 the plan assets of defined benefit pension plan included the Company's bonds representing 1% (2003 – 3%) of the total plan assets.

23. Provisions

Legal Claims

As of December 31, 2004 the Company accrued a provision in the amount of 16,000 (2003 - nil) in respect of a legal claim brought against the Company.

In January 2005 the Arbitration court of Khabarovsk announced its resolution, pursuant to which the Company was obligated to pay compensation amounting to 23,610. During the negotiation process parties have signed amicable agreement. According to this agreement the Company should pay compensation in amount of 16,000.

This provision is recognized in other operating expenses for the year ended December 31, 2004. The balance of the provision at December 31, 2004 is expected to be utilized in the first half of 2005.

24. Revenues

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

By revenue types	**2004**	**2003**
Long distance telephone services – national	**2,599,667**	2,383,640
Long distance telephone services – international	**524,012**	484,875
Local telephone services	**2,146,724**	1,732,195
Installation and connection fees	**728,680**	447,821
Documentary services	**33,267**	30,730
Cellular services	**340,459**	234,476
Radio and TV broadcasting	**198,415**	182,189
Data transfer and telematic services	**160,854**	153,564
New services	**490,226**	331,232
Rent of telephone channels	**126,666**	130,187
Service for national operators	**975,735**	283,953
Other telecommunications services	**427,870**	333,475
Other revenue	**180,979**	134,202
Total	**8,933,554**	6,862,539

The Company identifies revenue by the following major customer groups:

Customer groups	**2004**	**2003**
Residential customers	**4,707,171**	3,693,450
Corporate customers	**3,027,008**	2,220,126
Government customers	**884,845**	676,090
Tariff compensation from the state budget	**314,530**	272,873
Total	**8,933,554**	6,862,539

(in thousands rubles)

25. Other Operating Expenses, net

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

	2004	2003
Security and fire protection services	**129,603**	96,711
Rent of premises	**92,658**	59,707
Transportation services	**77,147**	50,679
Business travel expenses and representation costs	**70,825**	46,083
Payments to Non-Commercial Partnership (Note 33)	**60,500**	80,059
Professional services	**49,009**	33,170
Insurance of property, plant and equipment	**46,677**	31,497
Civil defense	**39,432**	25,106
Advertising expenses	**31,767**	23,591
Banks service fees	**31,146**	23,933
Impairment charge of construction in progress	**27,151**	5,301
Telecommunication regulatory fees	**26,631**	20,058
Payments to labor unions, cultural events expenses	**20,920**	16,526
Cost of telephone cards and Internet cards	**18,671**	17,721
Legal claims provision (Note 23)	**16,868**	323
Training expenses	**16,557**	11,619
Post services	**7,485**	8,272
Current assets written-off	**7,232**	412
Other expenses	**123,440**	105,674
Total	**893,719**	656,442

26. Interest Expense, net

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

	2004	2003
Interest income	**(6,260)**	(1,767)
Interest expense	**77,538**	34,482
Interest expense accrued on finance leases	**212,060**	73,419
Total	**283,338**	106,134

27. Gain/(loss) from Sale of Subsidiary, Associates and Other Investments

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

	2004	2003
Gain from sale of associates (Note 7)	**564,279**	–
Gain from sale of subsidiary (Note 17)	**3,513**	–
Gain/(loss) from sale of other investments	**5,754**	(1,331)
Recovery of impairment provision of other investments	**10,417**	219
Dividends	**252**	604
Total	**584,215**	(508)

(in thousands rubles)

28. Income Tax

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

	2004	2003
Current income tax expense	**497,159**	148,634
Deferred income tax benefit	**(138,909)**	(3,935)
Total income tax expense	**358,250**	144,699

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

	2004	2003
Profit before income tax and minority interest	**1,114,317**	317,364
Statutory income tax rate	**24%**	24%
Theoretical tax charge at statutory income tax rate	**267,436**	76,167
Increase (decrease) resulting from the effect of:		
Non-taxable income	**(10,090)**	(10,907)
Expenses not deductible for tax purposes	**100,904**	79,439
Total income tax charge for the year at the effective rate of 32.15% (2003 - 45.59%)	**358,250**	144,699

Deferred income tax assets and liabilities as of December 31, 2004 and 2003 were as follows:

	December 31, 2004	December 31, 2003
Deferred tax assets:		
Accounts payable and accrued expenses	**82,270**	76,087
Provision for impairment of receivable	**94,083**	31,612
Finance lease	**32,050**	9,823
Deferred revenue	**24,133**	23,860
Other	**11,171**	3,591
Deferred tax asset, total	**243,707**	144,973
Deferred tax liabilities:		
Property, plant and equipment	**(917,850)**	(892,124)
Intangible assets	**(10,945)**	(2,988)
Investments into associates	**(1,203)**	(74,679)
Investment revaluation effect	**(50,551)**	(805)
Other	**–**	(214)
Deferred income tax liability, total	**(980,549)**	(970,810)
Total deferred income tax liability, net	**(736,842)**	(825,837)

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

	2004	2003
Deferred tax liability, net at January 1	**(825,837)**	(828,967)
Deferred tax benefit	**138,909**	3,935
Deferred tax expense related to changes in fair value of investments available-for-sale	**(49,746)**	(805)
Deferred tax assets disposal due to sale of subsidiary	**(168)**	–
Net deferred tax liability at December 31	**(736,842)**	(825,837)

(in thousands rubles)

29. Earnings per Share

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

	2004	2003
Weighted average number of preference shares outstanding (thousands)	**31,169**	31,169
Weighted average number of ordinary shares outstanding (thousands)	**95,581**	95,581
Weighted average number of ordinary and preference shares outstanding (thousands)	**126,750**	126,750
Net profit	**756,067**	172,574
Earning per share, (basic/diluted)	**5.97**	1.36

As there are no dilutive instruments, basic earnings per share equal the diluted earnings per share.

30. Dividends Declared and Proposed for Distribution

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

Dividends declared and approved during the year:

	2004	2003
Dividends on ordinary shares – 0.40 Rubles per share (2003 – 0.31 Rubles per share)	**38,233**	29,630
Dividends on preference shares – 0.73 Rubles per share (2003 – 0.58 Rubles per share)	**22,753**	18,078
Total	**60,986**	47,708

Dividends declared and approved subsequent to December 31, 2004:

Dividends on ordinary shares – 1.20 Rubles per share	114,697
Dividends on preference shares – 3.61 Rubles per share	112,520
Total	**227,217**

31. Contingencies and Operating Risks

Operating Environment of the Company

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

31. Contingencies and Operating Risks (continued)

Operating Environment of the Company (continued)

Management cannot predict what effect changes in fiscal, political or tariff policies may have on the Company's current financial position or its ability to make future investments in property, plant and equipment. The consolidated financial statements do not include any adjustments that might result from these uncertainties. Related effects will be reported in the financial statements as they become known and estimable.

Taxation

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

During 2004 a tax examination of the Company's operations for the years 2001-2002 was executed by the tax authorities. As a result, the Company received a claim totaling 718,080, including fines and penalties of 256,245.

As of December 31, 2004 management believes that its interpretation of the relevant legislation is appropriate and that it is probable that the Company's tax, currency and customs positions will be sustained. As such, no provision has been made for the above mentioned claim.

Insurance Coverage

During 2004, the Company did not maintain insurance coverage on a significant part of its property, plant and equipment, business interruption losses, or third party liability in respect of property or environmental damage arising from accidents relating to the Company's property or the Company's operations. Until the Company obtains adequate insurance coverage, there is a risk that losses resulting from destruction of certain assets could have a material adverse effect on the Company's operations and financial position.

Legal Proceeding

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

Management is unable to estimate what developments may occur in respect of the Russian legal system or the resulting effect of any such developments on the Company's financial condition or future results of operations. The financial statements do not include any adjustment that may result from these uncertainties.

31. Contingencies and Operating Risks (continued)

Legal Proceeding (continued)

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.

Licenses

Substantially all of the Company's revenues are derived from operations conducted pursuant to licenses granted by the Russian Government. These licenses expire in various years ranging from 2005 to 2012. The Company has renewed these licenses on a regular basis in the past, and believes that it will be able to renew licenses without additional cost in the normal course of business. Suspension or termination of the Company's main licenses or any failure to renew any or all of these main licenses could have a material adverse effect on the financial position and operations of the Company.

32. Commitments

Guarantees Issued

The Company guaranteed credit line facilities provided by Sberbank to CJSC RTC-Leasing, a lessor of telecommunication equipment, as of December 31, 2004 (Note 19). The guarantees amounted to 1,816,342 (2003 - 800,404).

Capital Investments

As of December 31, 2004 and 2003 the Company has commitments of 88,771 and 143,446, respectively, for capital investments into modernization and expansion of its network.

33. Balances and Transactions with Related Parties

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

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

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

(in thousands rubles)

33. Balances and Transactions with Related Parties (continued)

Sale of Services

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

Related party	Relationship	Type of sales	Price determination method	2004	2003
OJSC Rostelecom	Svyazinvest Group Company	Telecommunication services	Regulated tariff	**309,771**	169,715
CJSC Rostelegraph	Investee company	Telecommunication services (rent of channels)	Regulated tariff	**30,840**	1,444
CJSC Akos	Significant representation on BOD	Telecommunication services	Market price	**19,339**	4,125
CJSC TeleRoss-Vladivostok	Associate	Telecommunication services	Market price	**18,731**	6,280
TOTAL:				**378,681**	181,564

Purchases

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

Related party	Relationship	Type of sales	Price determination method	2004	2003
OJSC Rostelecom	Svyazinvest Group Company	Telecommunication services	Regulated tariff	**1,192,019**	823,239
OJSC RTComm.RU	Svyazinvest Group Company	Telecommunication services	Market price	**103,603**	7,088
NPF Telecom-Soyuz	Controlled by Svyazinvest through majority in BOD	Non-state pension plan	Contracted fees	**69,052**	22,620
NCP Center for Research of problems in development of telecommunications	Svyazinvest Group Company	Target membership fees	Contracted fees	**60,500**	80,059
CJSC Rostelegraph	Investee company	Telecommunication services	Regulated tariff	**32,873**	4,388
OJSC Giprosvyaz	Svyazinvest Group Company	Telecommunication services	Market price	**13,068**	1,691
LLC Magalyaskom	Associate	Telecommunication services	Market price	**4,706**	5,734
TOTAL:				**1,475,821**	944,819

(in thousands rubles)

33. Balances and Transactions with Related Parties (continued)

Balances with Related Parties

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

Accounts receivable:

Related party	Relationship	Type of receivable	2004	2003
NCP Center for Research of problems in development of telecommunications	Svyazinvest Group Company	Target membership fees, agent guarantees	**41,024**	–
CJSC Akos	Significant representation on BOD	Telecommunication services	**17,294**	–
JSCB Svyazbank	Svyazinvest Group Company	Payments to agent	**12,380**	–
OJSC Giprosvyaz – 4	Svyazinvest Group Company	Telecommunication services	**7,458**	736
CJSC TeleRoss-Vladivostok	Associate	Telecommunication services	**3,693**	1,969
TOTAL:			**81,849**	2,705

Accounts payable:

Related party	Relationship	Type of payable	2004	2003
OJSC Rostelecom	Svyazinvest Group Company	Telecommunication services	**82,167**	76,700
NCP Center for Research of problems in development of telecommunications	Svyazinvest Group Company	Target membership fees	**30,451**	17,614
NPF Telecom-Soyuz	Controlled by Svyazinvest through majority in BOD	Non-state pension plans	**13,800**	3,082
CJSC RusLeasingSvyaz	Svyazinvest Group Company	Leasing	**6,737**	8,009
OJSC RTComm.RU	Svyazinvest Group Company	Telecommunication services	**4,102**	7,566
LLC Magalyaskom	Associate	Telecommunication services, rent of equipment	**1,047**	–
TOTAL:			**138,304**	112,972

33. Balances and Transactions with Related Parties (continued)

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.

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 expense associated with traffic carried by OJSC Rostelecom and terminated outside of the Company's network is stated as interconnection charges. Further, OJSC Rostelecom uses the Company's network to provide incoming long-distance and international traffic to its subscribers and partner operators.

Transactions with Government Organizations

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

Government subscribers accounted for approximately 41% of trade accounts receivable as of December 31, 2004 (2003 – 47%). Amounts outstanding from government subscribers as of December 31, 2004, amounted to 396,431 (2003 - 388,236) (see Note 12).

Non-Commercial Partnership Center for Research of Problems in Development of Telecommunications

Non-commercial partnership Center for Research of the Problems in Development of Telecommunications (hereinafter "the Partnership") is an entity OJSC Svyazinvest controls through its subsidiaries. The Company has an agreement with the Partnership, under which it provides funding for industry research and common administrative activities on behalf of the Company and other subsidiary and associates of OJSC Svyazinvest. Payments to the Partnership included in other operating expenses in the accompanying consolidated statement of operations for the year ended December 31, 2004 amounted to 60,500 (2003 - 80,059).

33. Balances and Transactions with Related Parties (continued)

NPF Telecom-Soyuz

The Company has a number of pension agreements with NPF Telecom-Soyuz (see Note 22 "Pension Plans and Employee Benefits"). OJSC Svyazinvest holds the majority in the Board of Directors of NPF Telecom-Soyuz ("the Fund"), because Svyazinvest Group is the main contributor of this Fund. Payments from the Company to the Fund in 2004 amounted to 55,152 (2003 - 40,994).

Compensation to Key Management Personnel

Key management personnel comprise members of the Management Board and the Board of Directors of the Company, totaling 21 persons as of December 31, 2004 and 2003. Total compensation to key management personnel included in the statement of operations "Wages, salaries, other employee benefits and payroll taxes" amounted to 33,757 and 34,633 for the years ended December 31, 2004 and 2003, respectively.

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

34. Financial Instruments

Fair Value

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

Carrying value of monetary assets and liabilities approximate their fair value. Balance sheet items denominated in foreign currency have been translated into Rubles using the corresponding exchange rate prevailing at the reporting date.

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

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 potentially subject of the Company's credit risk, consist principally of trade receivables. The carrying amount of accounts receivable, net of provision for impairment of receivables, represents the maximum amount exposed to credit risk.

The Company has no significant concentrations of credit risk due to significance of the client base and regular monitoring procedures over customers' and other debtors' ability to pay debts. A part of accounts receivable is represented by state and other non-commercial organizations. Recovery of this debt is influenced by political and economic factors, however, management believes that as of December 31, 2004 there is no significant risk of loss to the Company beyond the provision already recorded.

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

(in thousands rubles)

34. Financial Instruments (continued)

Foreign Exchange Risk

Foreign exchange risk is the risk that fluctuations in exchange rates will adversely affect items in the Company's statement of operations, balance sheet and/or cash flows. Foreign currency denominated liabilities (see Notes 18 and 19) give rise to foreign exchange exposure.

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

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

Interest Rate Risk

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

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

As of December 31, 2003:	**< 1 year**	**1-5 years**	**> 5 years**	**Total**
Fixed rate				
Short-term obligations	(132,313)	–	–	(132,313)
Current portion of long-term obligations	(124,320)	–	–	(124,320)
Long-term obligations	–	(1,119,850)	–	(1,119,850)
Finance lease obligations	(247,404)	(606,718)	(1,025)	(855,147)

As of December 31, 2004:	**< 1 year**	**1-5 years**	**> 5 years**	**Total**
Fixed rate				
Short-term obligations	**(120,373)**	**–**	**–**	**(120,373)**
Current portion of long-term obligations	**(1,238,521)**	**–**	**–**	**(1,238,521)**
Long-term obligations	**–**	**(513,219)**	**–**	**(513,219)**
Finance lease obligations	**(343,262)**	**(1,063,904)**	**(630)**	**(1,407,796)**

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 borrowings, which bear floating rates of interest.

The Company has no significant interest-bearing assets.

35. Subsequent Events

Sale of OJSC Daltelecom International

On February 14, 2005 the Company's Board of Directors approved the sale of 6.4483% shares of OJSC Daltelecom International for USD 7,975 (221,967 Rubles at an exchange rate prevailing on the date of sale). OJSC Dal Telecom International provides telecommunication services on the territory of the Russian Federation. The sale was executed to OJSC Vimpelcom on February 24, 2005.

Purchase of LLC Besprovodnye Informatsionnye Technology

On April 14, 2005 the Company acquired LLC Besprovodnye Informatsionnye Technology for 139,305. As a result of the acquisition the Company owns 100% of stake of LLC Besprovodnye Informatsionnye Technology. LLC Besprovodnye Informatsionnye Technology operates in the Far East region. The main activity of LLC Besprovodnye Informatsionnye Technology is rendering mobile telecommunication services.

Purchase of CJSC Integrator.ru

On May 31, 2005 the Company acquired CJSC Integrator.ru for 3,500 thousands USD. CJSC Integrator.ru is holder of 92.26% of CJSC Akos that provides cellular services in the Far East region.

Promissory Notes Transfer Agreements with Vneshtorgbank

In February 2005 the Company entered into 3 agreements on transfer of promissory notes with Vneshtorgbank for 350,968. Promissory notes mature in August 2006. The discount related to these promissory notes amounted to 58,968.

Dividends

In June 2005, the general meeting of the Company's shareholders approved dividends for 2004 in the amount of 3.61 Rubles per preference share and 1.20 Rubles per ordinary share. Total dividends declared amounted to 112,520 and 114,697 for preference and ordinary shares, respectively. Dividends for the year ended December 31, 2004, are payable during 2005 and will be accrued in the financial statements for the year ended December 31, 2005 (see also Note 30 "Dividends Declared and Proposed for Distribution").

Telecommunication Reform

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

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

35. Subsequent Events (continued)

Telecommunication Reform (continued)

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

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

Privilege Subscribers

Article 47 of Federal Law "On Telecommunications" No. 126-FZ dated July 7, 2003 changes the rules on granting privileges to residential customers for services rendered by telecommunication companies starting 2005. Commencing from January 2005 telecommunication customers with the right on privileges are obliged to pay for telecommunication services in full with the subsequent compensation of their expenses by budget funds of respective levels, except for two regional branches: Magadan and Primorie. In the Magadan branch the contract with Government Department of Social Support was concluded on April 22, 2005, in the Primorie branch such contract is in process of approval in Region State Administration. These contracts will be effective during 2005.

Unified Social Tax

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

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

The Company's management is not able to estimate the effect of the change of the unified social tax rate effective January 1, 2005 on its net profit for 2005.