

OJSC COMSTAR UTS AND SUBSIDIARIES

Independent Auditors' Report

Financial Statements

Years ended December 31, 2008 and 2007

OJSC COMSTAR UTS AND SUBSIDIARIES

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INDEPENDENT AUDITORS' REPORT

To the Shareholders of Comstar UTS:

We have audited the accompanying consolidated balance sheets of OJSC "Comstar-United TeleSystems" and its subsidiaries (the "Group") as of December 31, 2008 and 2007 and the related consolidated statements of operations and comprehensive income, changes in shareholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, such consolidated financial statements presented fairly, in all material respects, the financial position of the Group as of December 31, 2008 and 2007, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As described in Note 2 to the consolidated financial statements, the Group changed its accounting policy with respect to the accounting for and presentation of acquisitions in the statement of operations in the year acquired, effective January 1, 2008. All comparative historic information in the consolidated statements of operations and of cash flows, as well as the respective disclosures for the year ended December 31, 2007, have been restated to conform to the new accounting policy.

Further, as described in Note 13 to the financial statements, the Group has determined that its investment in the shares of OJSC "Telecommunication Investment Company" ("Svyazinvest"), amounted to \$1,241 million as of the December 31, 2008 is not other than temporarily impaired. In the absence of readily ascertainable market information related to the fair value of the investment in Svyazinvest, management reached its conclusion based on the use of estimates incorporating various unobservable market inputs as discussed in Note 13. Because of the uncertainty inherent in such analysis, the value the Group could realize had a disposal of this investment been made between a willing buyer and seller may differ materially from its carrying amount.



April 24, 2009

OJSC COMSTAR UTS AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31, 2008 AND 2007

(Amounts in thousands of US dollars)

		December 31,	
	Note	2008	2007
Assets			
Current assets:			
Cash and cash equivalents	4	\$ 32,710	\$ 179,794
Short-term investments and loans	5	349,970	425,929
Trade receivables, net.....	6	157,489	163,028
Other receivables, prepaid expenses and other current assets	7	70,756	101,668
Inventories and spare parts.....	8	25,166	41,328
Deferred tax assets, current portion.....	24	11,142	29,910
Total current assets		647,233	941,657
Goodwill.....	9	3,517	4,209
Property, plant and equipment, net	10	1,800,128	1,907,112
Intangible assets, net.....	11	198,935	186,797
Investments in shares of Svyazinvest.....	12	1,240,977	1,485,378
Other long-term investments and loans.....	13	238,166	99,731
Other non-current assets	14	7,150	5,453
Total assets		\$ 4,136,106	\$ 4,630,337
Liabilities and shareholders' equity			
Current liabilities:			
Trade accounts payable, accrued expenses and other current liabilities ...	15	\$ 228,977	\$ 178,954
Deferred connection fees, current portion		29,387	35,787
Subscriber prepayments		40,683	48,767
Debt, current portion	16	426,681	103,476
Capital lease obligations, current portion	17	5,517	10,360
Put option	18	—	88,000
Total current liabilities		731,245	465,344
Long-term liabilities:			
Deferred connection fees, net of current portion		96,115	117,884
Debt, net of current portion	16	781,955	891,321
Capital lease obligations, net of current portion	17	1,019	6,150
Retirement and post-retirement obligations	19	29,250	35,817
Property, plant and equipment contributions.....	20	93,197	112,779
Deferred tax liabilities, long-term portion	24	101,202	114,123
Payable to Sistema Hals, related party	26, 27, 30	36,807	30,815
Other long-term liabilities		1,874	194
Total long-term liabilities.....		1,141,419	1,309,083
Total liabilities.....		1,872,664	1,774,427
Commitments and contingencies	27		
Minority interests.....		703,891	765,005
Shareholders' equity:			
Common stock, at par (par value of 1 Ruble, 417,940,860 shares authorized and issued).....	28	23,900	23,900
Treasury stock, at par (59,716,004 and 13,484,004 shares as of December 31, 2008 and 2007, respectively)		(2,545)	(857)
Additional paid-in capital		1,068,985	1,425,044
Retained earnings.....		649,478	472,431
Accumulated other comprehensive (loss)/income.....		(180,267)	170,387
Total shareholders' equity		1,559,551	2,090,905
Total liabilities and shareholders' equity.....		\$ 4,136,106	\$ 4,630,337

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

OJSC COMSTAR UTS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME FOR THE YEARS ENDED DECEMBER 31, 2008 and 2007

(Amounts in thousands of US dollars, except for share and per share amounts)

		Years ended December 31,	
	Note	2008	2007
Operating revenues.....	22	\$ 1,647,665	\$ 1,481,522
Operating expenses, excluding depreciation and amortization and stock-based compensation, net	23	(965,092)	(843,674)
Depreciation and amortization	10, 11, 20	(195,671)	(170,752)
Stock-based compensation	28	6,943	(10,287)
Operating income		493,845	456,809
Other income and expenses:			
Interest income.....		38,096	15,052
Interest expense, net of interest capitalized.....		(71,979)	(53,440)
Change in fair value of derivative financial instruments.....	18	(41,554)	(145,859)
Impairment of long-term investments and loans.....	5, 13	(1,878)	(22,691)
Foreign currency transactions loss, net		(998)	(4,555)
Gain from disposal of an affiliate.....	3	—	3,216
Income before income tax, income from affiliates and other investees and minority interests.....		415,532	248,532
Income tax expense	24	(106,098)	(111,001)
Income from affiliates and other investees		2,993	2,703
Minority interests		(132,782)	(96,421)
Net income		\$ 179,645	\$ 43,813
Other comprehensive (loss)/income:			
Unrecognized actuarial losses, net of minority interest of (\$718) and \$7,219, respectively, and income tax of \$nil and \$nil, respectively	19	903	(9,089)
Translation adjustment, net of minority interest of \$216,075 and (\$36,360), respectively, and income tax of \$nil and \$nil, respectively		(351,557)	126,547
Comprehensive (loss)/income		\$ (171,009)	\$ 161,271
Weighted average number of common shares outstanding:			
Basic.....	29	399,909,446	361,394,049
Diluted.....	29	411,800,316	373,488,887
Earnings per common share:			
Basic.....	29	\$ 0.45	\$ 0.12
Diluted.....	29	\$ 0.41	\$ 0.12

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

OJSC COMSTAR UTS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2008 and 2007 (Amounts in thousands of US dollars)

	Years ended December 31,	
	2008	2007
Cash flows from operating activities:		
Net income	\$ 179,645	\$ 43,813
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation and amortization	195,671	170,752
Change in fair value of derivative financial instruments (Note 18)	41,554	145,859
Impairment of long-term investments and loans	1,878	22,691
Stock-based compensation (Note 28)	(6,943)	10,287
In-kind compensation from third parties (Note 23)	(10,679)	(10,778)
Loss from disposal of fixed assets and other non-cash items, net	4,341	1,484
Gain from disposal of an affiliate (Note 3)	–	(3,216)
Amortization of deferred finance charges	400	4,019
Deferred taxes (Note 24)	9,393	9,871
Income from affiliates and other investees, net of dividends received	–	(620)
Foreign currency transactions loss/(gain) on non-operating activities, net ..	11,042	(1,093)
Postretirement benefits (Note 19)	860	7,572
Minority interests	132,782	96,421
Bad debt expense	6,552	5,374
Inventory obsolescence charge and other provisions	2,475	4,932
Changes in operating assets and liabilities:		
Trade receivables	(30,053)	(52,708)
Other receivables and prepaid expenses	16,602	9,852
Inventories and spare parts	1,919	(8,784)
Trade accounts payable, accrued expenses and other current liabilities ..	40,652	37,609
Deferred connection fees	(3,379)	(3,964)
Subscriber prepayments	(1,094)	(1,017)
Net cash provided by operating activities	593,618	488,356
Cash flows from investing activities:		
Purchases of property, plant and equipment	(333,118)	(303,416)
Proceeds from sale of property, plant and equipment	5,873	4,690
Purchase of a derivative financial instrument (Note 18)	(19,422)	–
Purchases of intangible assets	(20,857)	(42,013)
Prepayment for the 2009 purchase of Stream TV (Note 13)	(121,094)	–
Acquisition of subsidiaries, net of cash acquired (Note 3)	(50,156)	(183,162)
Acquisition of minority interests in existing subsidiaries (Note 3)	(1,684)	(1,832)
Purchases of long-term investments and loans (Note 13)	(42,222)	(21,382)
Proceeds from sale and redemption of long-term investments and loans (Note 13)	425	36,780
Purchases of short-term investments and loans	(491,543)	(447,707)
Proceeds from sale and redemption of short-term investments and loans	538,108	96,575
Decrease in restricted cash	2,476	1,561
Net cash used in investing activities	(533,214)	(859,906)

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

OJSC COMSTAR UTS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (continued) FOR THE YEARS ENDED DECEMBER 31, 2008 and 2007 (Amounts in thousands of US Dollars)

	Years ended December 31,	
	2008	2007
Cash flows from financing activities:		
Cash payments and proceeds from the exercise of put and call options (Note 18)	(100,000)	322,237
Acquisition of treasury stock	—	(32)
Proceeds from borrowings (Note 16)	192,931	849,530
Principal payments on borrowings (Note 16)	(200,160)	(712,461)
Principal payments on capital lease obligations	(9,274)	(17,194)
Deferred finance charges	—	(1,492)
Dividends paid	(38,250)	(37,031)
Net cash (used in)/provided by financing activities	(154,753)	403,557
Effects of foreign currency translation on cash and cash equivalents	(52,735)	11,166
Net (decrease)/increase in cash and cash equivalents	(147,084)	43,173
Cash and cash equivalents, beginning of the year	179,794	136,621
Cash and cash equivalents, end of the year	\$ 32,710	\$ 179,794
Supplemental cash flows information:		
Cash paid for interest, net of amounts capitalized	\$ 79,684	\$ 48,057
Income taxes paid	100,332	98,801
Non-cash investing and financing activities:		
Contributed property, plant and equipment (Note 20)	3,194	6,299
Cost of construction incurred in transactions with Sistema Hals, a subsidiary of Sistema (Notes 26, 27 and 30)	11,001	17,621
Increase/(decrease) in accounts payable for the acquisition of property, plant and equipment	48,236	(4,813)
Equipment acquired through vendor financing	810	2,770
Building contributed in the share capital of Sistema Mass Media (Note 13)	—	4,751
Debt issued in the course of exercise of the put option (Notes 16 and 18)	363,552	—

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

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CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY FOR THE YEARS ENDED DECEMBER 31, 2008 and 2007

(Amounts in thousands of US dollars)

	Common stock	Treasury stock	Additional paid-in capital	Retained earnings	Accumula- ted other compre- hensive income / (loss)	Total
Balances at						
January 1, 2007	\$ 23,900	\$ (4,004)	\$ 1,064,225	\$ 433,145	\$ 52,929	\$ 1,570,195
Effect of adoption of FIN No. 48, net of minority interest of \$1,061 (Note 2)	—	—	—	(2,415)	—	(2,415)
Stock-based compensation (Note 28)	—	—	(651)	—	—	(651)
Exercise of the call option, net of minority interest of \$183,821 (Note 18)	—	3,147	358,713	—	—	361,860
Acquisition of minority interest in Golden Line, net of tax of \$2,032 (Note 3)	—	—	2,789	—	—	2,789
Acquisition of treasury stock	—	—	(32)	—	—	(32)
Dividends declared	—	—	—	(2,112)	—	(2,112)
Net income	—	—	—	43,813	—	43,813
Unrecognized actuarial losses (Note 19), net of minority interest of \$7,219 and tax of \$nil	—	—	—	—	(9,089)	(9,089)
Translation adjustment, net of minority interest of \$36,360 and tax of \$14,513	—	—	—	—	126,547	126,547
Balances at						
December 31, 2007	\$ 23,900	\$ (857)	\$ 1,425,044	\$ 472,431	\$ 170,387	\$ 2,090,905
Exercise of the put option (Note 18)	—	(1,688)	(345,052)	—	—	(346,740)
Reorganization of Comstar-Direct (Note 3)	—	—	(11,007)	—	—	(11,007)
Dividends declared	—	—	—	(2,598)	—	(2,598)
Net income	—	—	—	179,645	—	179,645
Unrecognized actuarial losses (Note 19), net of minority interest of \$718 and tax of \$nil	—	—	—	—	903	903
Translation adjustment, net of minority interest of \$216,075 and tax of \$nil	—	—	—	—	(351,557)	(351,557)
Balances at						
December 31, 2008	\$ 23,900	\$ (2,545)	\$ 1,068,985	\$ 649,478	\$ (180,267)	\$ 1,559,551

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

OJSC COMSTAR UTS AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2008 and 2007 (Amounts in thousands of US dollars, unless otherwise stated)

1. DESCRIPTION OF THE BUSINESS

Nature of the Business

Open Joint-Stock Company “COMSTAR–United TeleSystems” (“Comstar UTS”) and subsidiaries (together referred to as “the Company”, or “the Group”) is a provider of fixed line communications services, including voice, broadband and dial-up Internet access, pay TV and various value added services, to commercial and residential customers throughout the Moscow metropolitan area and in several other regions in Russia, Ukraine and Armenia. The controlling shareholder of Comstar UTS is JSFC AFK Sistema (“Sistema”). Primary operating entities of the Group are incorporated in the Russian Federation (“the RF”), Ukraine and Armenia.

The shares of Comstar UTS in the form of global depositary receipts (“GDRs”), with one GDR representing one share, were admitted to trade on the London Stock Exchange.

Operating Environment

During late 2008, major economies around the world experienced volatile capital and credit markets. A number of major global financial institutions have either been placed into bankruptcy, taken over by other financial institutions and/or supported by government funding. This has resulted in a significant worldwide economic downturn. The ongoing financial crisis has resulted in capital markets instability, significant deterioration of liquidity and tighter credit conditions within Russia. While the Russian Government has introduced a range of stabilization measures aimed at providing liquidity and supporting refinancing of foreign debt for Russian banks and companies, there continues to be uncertainty regarding the economy, general business conditions, access to capital and the marginal cost of such capital for the Group and its counterparties and as well as consumer purchase patterns, which could affect the Group’s financial position, results of operations and business prospects.

To date, the Group’s operations have not been directly impacted by the economic downturn and credit tightening, other than the increase in the interest rate on certain Group’s borrowings (see Note 16).

Working Capital Deficit

As of December 31, 2008, the Group had a working capital deficit (i.e. excess of current liabilities, including nonmonetary, over current assets, including nonmonetary) of \$84.0 million, which was primarily attributable to the short-term portion of a RUR 26.0 billion credit facility from Sberbank and \$263.6 million outstanding under the notes payable to Access to fund the put option exercise (see Note 16). During 2009, management expects to finance this deficit using the Group’s operating cash flows and by obtaining external long-term borrowings to the extent necessary. While access to such financing has become more difficult with the tightened credit markets, management believes it will be able obtain such financing due to reasonable gearing and good credit standing of the Group, however expects the associated financing costs to increase. In addition, capital expenditures, such as acquisition of property, plant and equipment or expenditures related to the upgrades or expansion of the Group’s networks, can be deferred to meet short-term liquidity requirements. Accordingly, management believes that cash flows from operating and financing activities, along with reductions in spending it is able to make, will be sufficient for the Group to meet its obligations as they become due.

OJSC COMSTAR UTS AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEARS ENDED DECEMBER 31, 2008 and 2007 (Amounts in thousands of US dollars, unless otherwise stated)

Legal Mergers

During the years ended December 31, 2007 and 2008, Comstar UTS' wholly-owned subsidiaries Telmos, MTU-Inform, Contrast-Telecom, Porttelecom, Golden Line, TK Overta and Conversia-Svyaz were legally merged into Comstar UTS. These mergers were executed to streamline the decision-making process within the Group and had no material impact on the Company's financial statements.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The Group's operating entities maintain accounting records and prepare their financial statements in local currency in accordance with the requirements of accounting and tax legislation in the countries of their incorporation. These consolidated financial statements have been prepared in conformity with the accounting principles generally accepted in the United States of America ("US GAAP") and are expressed in terms of US dollars (see "Foreign Currency Translation Methodology" below). The accompanying consolidated financial statements differ from the financial statements prepared for statutory purposes because they reflect certain adjustments, which are appropriate to present the financial position, results of operations and cash flows in accordance with US GAAP.

The principal adjustments are related to revenue recognition, foreign currency translation, accounting for derivative financial instruments, deferred taxation, consolidation, and valuation and depreciation of property, plant and equipment and intangible assets.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of Comstar UTS and its subsidiaries, in which Comstar UTS exercises control through the ownership of majority voting interest.

All significant intercompany transactions, balances and unrealized gains (losses) have been eliminated.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEARS ENDED DECEMBER 31, 2008 and 2007 (Amounts in thousands of US dollars, unless otherwise stated)

The ownership interest of Comstar UTS and proportion of its voting power in its major operating subsidiaries as of December 31, 2008 and 2007 were as follows:

Operating entities	December 31, 2008		December 31, 2007	
	Ownership interest	Proportion of voting power	Ownership interest	Proportion of voting power
MGTS (*).....	56%	67%	56%	67%
Porttelecom (**)	—	—	100%	100%
Comstar-Direct (***)	100%	100%	52%	52%
Golden Line (**).....	—	—	100%	100%
Digital Telephone Networks – South (DTN).....	100%	100%	100%	100%
Regional Technical Centre (RTC)	86%	86%	88%	88%
Urals Telephone Company (UTC)	100%	100%	—	—
Intersvyazservice	100%	100%	—	—
Inter-TV Media	100%	100%	—	—
Tyumenneftegazsvyaz (TNGS) (****)	—	—	75%	89%
TK Overta (**).....	—	—	100%	100%
Conversiya-Svyaz (**).....	—	—	100%	100%
Unitel	100%	100%	100%	100%
AMT	56%	67%	56%	67%
Astelit	100%	100%	100%	100%
Comstar Ukraine	100%	100%	100%	100%
Technological Systems	100%	100%	100%	100%
TC Digital Global Telecommunications	100%	100%	100%	100%
Degre	100%	100%	100%	100%
Neophone	100%	100%	100%	100%
Callnet	75%	75%	75%	75%
Cornet	75%	75%	75%	75%

(*) The Group's voting power in MGTS may be affected by potential voting rights of MGTS' preferred stock as discussed in Note 21.

(**) Legally merged with Comstar UTS in 2008.

(***) The Group's ownership and voting interest in Comstar-Direct increased in 2008 as a result of reorganization of Comstar-Direct as described in Note 3.

(****) Legally merged with RTC in 2008.

The ownership interest of Comstar UTS in its subsidiaries is determined by taking into account both the common and preferred (non-voting) shares.

Change in accounting policy

Effective January 1, 2008, the Group has changed its accounting policy with respect to the presentation of acquisitions in the statement of operations in the year acquired. Previously, the Group adopted a policy permitted by Accounting Research Bulletin No. 51, "Consolidated Financial Statements" (ARB No. 51) to include revenues and expenses of newly acquired subsidiaries in the consolidated statement of operations as if they had been acquired at the beginning of the year in

OJSC COMSTAR UTS AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEARS ENDED DECEMBER 31, 2008 and 2007 (Amounts in thousands of US dollars, unless otherwise stated)

which control is obtained. Accordingly, the pre-acquisition earnings were included as a deduction in the statements of operations to arrive at net income for the period.

The Group's change in accounting policy was to another acceptable method as permitted under ARB No. 51. According to the new accounting policy, revenues and expenses of newly acquired subsidiaries are consolidated in the statement of operations from the acquisition date instead of the beginning of the year when control was acquired.

Management believes that new policy better reflects the manner in which the performance of the Group is reported and managed internally. Further, as the new policy is consistent with common accounting practice both globally and in Russia, management believes that the change in accounting policy will result in a greater understanding of the Group's financial statements by the investment community and improved comparability with the financial statements of the Group's peers.

All comparative historical information in the statement of operations and statement of cash flows, as well as respective disclosures, has been restated to conform to the new accounting policy. The change had the following effects on the statement of operations for the year ended December 31, 2007:

	2007 Amounts previously reported	Adjustments	2007 Restated
Operating revenues.....	\$ 1,562,385	\$ (80,863)	\$ 1,481,522
Operating income	485,333	(28,524)	456,809
Income before income tax, income from affiliates and other investees and minority interests	277,538	(29,006)	248,532
Income from continuing operations.....	43,813	—	43,813

The change had no impact on net income and earnings per share for amounts previously reported in the statement of operations for the year ended December 31, 2007. There were no changes to the balance sheet as at January 1, 2007 and December 31, 2007 or to the net cash inflows/outflows for the year ended December 31, 2007.

Business Combinations and Goodwill

Acquisition of businesses from third parties is accounted for using the purchase method. On acquisition, the assets and liabilities of an acquired entity are measured at their fair values as at the date of acquisition. The interest of minority shareholders, if applicable, is stated at the minority's proportion of the book values of the assets and liabilities recognized. Goodwill arising on acquisitions is recognized as an asset and initially measured at cost, being the excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognized. Any excess of the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities over the cost of the business combination is allocated on a pro-rata basis to decrease the value of certain long-term assets.

The Group accounts for the acquisition of the minority interests using the purchase method. As a result of each step acquisition, the historical cost basis of the minority interest balance is reduced to the extent of the interest acquired, and the increased ownership obtained is accounted for by increasing the acquired entity's basis from historical cost to fair value for the portion of the assets acquired and liabilities assumed based on the additional ownership acquired.

OJSC COMSTAR UTS AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued) **FOR THE YEARS ENDED DECEMBER 31, 2008 and 2007** *(Amounts in thousands of US dollars, unless otherwise stated)*

Acquisitions of entities under common control are accounted for on a carryover basis, which results in the historical book value of assets and liabilities of the acquired entity being combined with that of the Group. Any difference between the purchase price and the net assets acquired is reflected in equity.

Use of Estimates

The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, amounts of revenues and expenses and disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

Examples of significant estimates include the allowance for doubtful accounts, the useful lives and recoverability of long-lived tangible and intangible assets, average subscriber lives, fair value of financial instruments, analysis of investments and loans for impairment and valuation allowances on deferred tax assets.

Concentration of Business Risk

The Group's principal business activities are within the RF. Laws and regulations affecting businesses operating in the RF are subject to rapid changes, and the Group's assets and operations could be at risk due to negative changes in the political and business environment.

Foreign Currency Translation Methodology

The primary financial statements of the entities of the Group are prepared and presented in the currency of the primary economic environment, in which each entity operates, i.e. its functional currency.

Prior to January 1, 2007 the functional currency of all the Group entities except for MGTS, Conversiya-Svyaz, TK Overta, TNGS and Golden Line was the US dollar ("USD"), because the majority of their revenues, costs, capital expenditures and debt were either priced, incurred, payable or otherwise measured in USD. Additionally, the functional currency of the companies acquired in 2007 and 2008 has been determined as RUR.

In January and February 2007, Comstar UTS, Telmos and MTU-Inform, for the purpose of subscriber billing, fixed the US dollar exchange rate at 28.70 Russian Rubles ("RUR") for 1 US dollar for a significant majority of the subscribers. Further, in June 2007 Comstar UTS re-financed its \$675.0 million USD-denominated loan with a RUR-denominated credit facility (see Note 13). As a result of these events, management has re-evaluated the functional currency criteria under FASB Statement ("SFAS") No. 52 and determined that these changes in facts and circumstances supported the change in functional currency. Therefore, effective from June 30, 2007, Comstar UTS (including Telmos and MTU-Inform which were legally merged into Comstar UTS in April 2007 as discussed in Note 1) has changed its functional currency to RUR. The effect of this change has been applied on a prospective basis. All non-monetary assets and liabilities were re-translated at the date of change, resulting in approximately \$12.2 million, net of income taxes of \$14.5 million, of the translation adjustment recorded in the statement of changes in shareholders' equity as part of other comprehensive income as of the date of the change.

Effective July 1, 2007, in connection with change of all tariffs previously denominated in or linked to the USD to RUR, Comstar-Direct has changed its functional currency to RUR. The effect of this change has not been material to the financial statements and has been applied on a prospective basis.

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The Group has selected the USD as the reporting currency and translates the financial statements of the Group into USD in accordance with provisions of SFAS No. 52. All assets and liabilities are translated at the exchange rates current at the balance sheet date. Shareholders' equity is translated at the applicable historical rates. Income and expenses and cash flows are translated at exchange rates at the dates on which those elements are recognized or close approximations to such rates. Translation gains and losses resulting from the use of such rates are reported in the statement of changes in shareholders' equity as part of other comprehensive income.

The official rate of exchange, as determined by the Central Bank of the RF ("CBR"), between RUR and USD at December 31, 2008 was 29.38 RUR to 1 US dollar (December 31, 2007: 24.55).

The translation of RUR-denominated assets and liabilities into US dollars for the purpose of these financial statements does not indicate that the Group could realize or settle in US dollars the reported values of the assets and liabilities. Likewise, it does not indicate that the Group could return or distribute the reported US dollar values of capital and retained earnings to its shareholders.

Revenue Recognition

The Group's revenues are principally derived from the provision of telecommunication services which primarily consist of (i) monthly subscription fees, (ii) traffic charges, (iii) connection fees, (iv) revenues from data transmission services, (v) revenues from value-added and additional telecommunication services, and (vi) revenues from services to other operators, including commission for provision of domestic and international long-distance ("DLD/ILD") services through the Group's network to the Group's subscribers, servicing the connection points, interconnection and rent of technological resources. The Group records revenues over the periods they are earned as follows:

- (i) Monthly subscription fees are recognized in the month during which the services are provided to the subscribers;
- (ii) Traffic charges are recognized as the services are provided;
- (iii) Upfront fees received for the connection of new subscribers are deferred and recognized over the expected subscriber relationship period, which generally varies between 1 and 15 years, depending on the type of the subscriber and the region of operations;
- (iv) Revenues from the provision of data transmission services are recognized when the services are provided to the subscribers;
- (v) Revenues derived from value-added and additional telecommunication services are recognized when the services are provided to the subscribers; and
- (vi) Revenues from services to other operators are recognized when the services are provided to the operators.

The Group reports revenue net of value-added tax ("VAT") and other taxes included in the sales price. In accordance with the Emerging Issues Task Force ("EITF") Issue No. 99-19, "Reporting Revenue Gross as a Principal versus Net as an Agent", the Group reports as revenue gross amounts billed to a customer when it has earned revenue from the sale of services or goods, or the net amount retained (that is, the amount billed to a customer less the amount paid to supplier) when it has earned a commission or a fee.

Local telephone services provided by MGTS, as well as the majority of MGTS' and Comstar UTS' services to operators, including interconnection and line rental, are regulated tariff services, and changes in rate structure are subject to the Federal Tariff's Service ("FTS") approval. See Note 22 for the amounts the Group earned for such services during the years ended December 31, 2008 and 2007.

Before January 1, 2005, MGTS was required to grant discounts ranging from 20% to 100% on installation and monthly fees to certain categories of residential subscribers, such as pensioners,

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military veterans and disabled individuals, and was entitled to reimbursement from the federal budget for these discounts. Due to the lack of certainty of reimbursement, MGTS accounted for such revenues upon collection. During the year ended December 31, 2007, MGTS received compensation from the federal budget in the amount of approximately \$36.6 million, which has been included in revenues for the respective year. As of December 31, 2008 and 2007, MGTS' claims to the federal budget in respect of aforementioned reimbursements were fully satisfied.

In accordance with legislation effective January 1, 2005, substantially all MGTS' subscribers are required to pay the full price for residential service, and those entitled to discounts are to receive reimbursement from the government rather than discounts from MGTS.

Historically, the Group has entered into interconnect agreements, under which the Group provides services to, and receives services from, other operators for a fixed periodic fee, regardless of the volume of the outgoing or incoming traffic. Revenues and expenses under these agreements are recognized in the amount of the net fixed fee receivable or payable by the Group.

Following the introduction of the new interconnect rules in 2006, these arrangements are being phased out and replaced with agreements under which the Group bills its counterparties for the use of its network and pays other operators for the calls of its subscribers to other operators' customers. Revenues under these arrangements are recognized in the amounts receivable by the Group and expenses are recorded for charges payable by the Group.

Cash and Cash Equivalents

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

Fair Value of Financial Instruments

Financial instruments carried on the balance sheet include cash and bank balances, receivables, investments and loans, derivatives (including purchased call option, written options granted in connection with the acquisition of Svyazinvest and foreign currency forwards (see Note 18), accounts payable, capital lease obligations and debt. The particular recognition methods adopted are disclosed in the individual policy statements associated with each item.

Long-Term Investments and Loans

Long-term financial instruments consist primarily of long-term investments and loans and long-term debt. It is not practicable for the Group to estimate the fair values of all of its long-term investments and loans, as quoted market prices are not readily available and, due to nature of the investments, valuations are not being completed or obtained (see also Note 12).

The Group does not discount promissory notes of and loans granted to related parties, interest rates on which are different from market rates. Accordingly, fair value of such notes and loans may be different from their carrying value.

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Short-Term Investments and Loans

Short-term investments and loans represent investments in promissory notes, loans and time deposits and other investments which have original maturities in excess of three months and mature within twelve months from the balance sheet date. These investments are being accounted for at amortized cost. Management periodically assesses the recoverability of the carrying values of the investments and, if necessary, records impairment losses to write the investment down to fair value.

The estimated fair value of such financial instruments as of December 31, 2008 approximated their carrying value due to the short-term nature of the investment.

Accounts Receivable

Accounts receivable are stated net of allowance for doubtful accounts. Such allowance reflects either specific cases or estimates based on evidence of collectibility.

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

Value-Added Taxes

VAT related to sales are payable to the tax authorities upon provision of services and issuance of an invoice to the customer. VAT incurred for purchases ("VAT recoverable") may be reclaimed, subject to certain restrictions, against VAT related to sales. Management periodically reviews the recoverability of the balance of VAT recoverable and believes that the amounts reflected in the financial statements are fully recoverable within one year.

Inventories and Spare Parts

Inventories and spare parts are primarily comprised of goods for resale, cables and spare parts and are stated at the lower of cost or market value. Cost is computed on a weighted average basis. The management periodically assesses inventories and spare parts for obsolete or slow moving stock and writes down such inventories and spare parts to their market value.

Property, Plant & Equipment

For the entities acquired by the Group in the common control transactions, property, plant and equipment ("PP&E") were recorded at their carrying amounts as of the date of acquisition. For all other entities acquired by the Group in transactions with third parties, PP&E were assigned their fair values at the date of acquisition by the Group. If fair values of the identifiable net assets of the acquired entities exceeded acquisition cost, the fair values of non-current assets held by the acquired entities at the acquisition date, including PP&E, were reduced by such excess. All subsequent purchases of PP&E have been recorded at cost.

Cost includes all costs directly attributable to bringing the asset to working condition for its intended use, except for rental costs, as well as major expenditures for improvements and replacements which extend useful lives of the assets or increase their value or revenue generating capacity. Repairs and maintenance are charged to the statements of operations as incurred. Interest expense incurred during the period of construction of the qualifying assets is capitalized as part of property, plant and equipment until the project is completed and the asset is placed into service. Interest expense capitalized for the years ended December 31, 2008 and 2007 amounted to \$15.4 million and \$15.7 million, respectively.

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Property, plant and equipment items transferred to MGTS free of charge (Note 20) are capitalized at their fair value at the date of transfer, and corresponding liability is recorded and amortized to the consolidated statements of operations over the contributed asset's useful life.

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

Property, plant and equipment are depreciated on a straight-line basis over the estimated useful lives of the assets as follows:

Buildings and constructions.....	20-47 years
Telecommunications equipment and cable (*)	7-31 years
Other fixed assets.....	3-25 years
Construction in-progress and equipment for installation	N/A

(*) Analogue switching equipment of MGTS is depreciated over the remaining useful lives ranging from 1 to 4 years.

Leasehold improvements are depreciated on a straight-line basis over the shorter of their useful life or lease term. The lease term includes renewals when such renewals are reasonably assured.

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

Lease Accounting

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

Asset Retirement Obligations

In accordance with SFAS No. 143, "Accounting for Asset Retirement Obligations", the Group estimates an asset retirement obligation and an associated asset retirement cost when the Group has a legal or contractual obligation in connection with the retirement of tangible long-lived assets. The Group's obligations under SFAS No. 143 arise from certain of its leases and relate primarily to the cost of removing equipment from such lease sites. As of December 31, 2008 and 2007, the estimated assets retirement obligations were not significant to the Group's consolidated financial position and results of operations.

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Intangible Assets

For the entities acquired by the Group in common control transactions, intangible assets were recorded at their carrying amounts at the date of acquisition by the Group. For all other entities acquired by the Group, intangible assets were recorded at their fair values at the date of acquisition by the Group. All subsequent purchases of intangible assets have been recorded at cost.

Current operating licenses of the Group do not provide for automatic renewal upon expiration. As the Group and the industry do not have sufficient experience with the renewal of licenses, license costs are being amortized during the initial license period without consideration of possible future renewals, subject to periodic review for impairment, on a straight-line basis over the license period starting from the date network in such license area becomes commercially operational. Amortization of other finite-life intangible assets, comprised mostly of acquired customer base, billing systems and other software, is computed on a straight-line basis over their estimated useful lives.

Goodwill Impairment

Annually, as of December 31, or more frequently if triggering events occur, the Group tests goodwill for impairment by comparing the fair value of each reporting unit with its carrying amount. Fair value of a reporting unit for the goodwill impairment test is determined utilizing a discounted cash flow analysis and other valuation methods as appropriate. If the carrying amount of a reporting unit exceeds its fair value, goodwill is considered potentially impaired, and further analysis to determine the amount of impairment, if any, is performed.

In determining fair value, management relies on a number of factors including operating results, business plans, economic projections, anticipated future cash flows and marketplace data. There are inherent uncertainties related to these factors and judgments in applying them to the analysis of goodwill impairment. However, fair value determinations require considerable judgment and are sensitive to changes in the factors described above. In light of current economic conditions, additional impairments to one or more of the Group's reporting units could occur in future periods whether or not connected to the annual impairment analysis.

Impairment of Long-Lived Assets Excluding Goodwill

The Group periodically evaluates the recoverability of the carrying amount of its long-lived assets in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". Whenever events or changes in circumstances indicate that the carrying amounts of those assets may not be recoverable, the Group compares the undiscounted net cash flows estimated to be generated by those assets to the carrying amount of those assets.

When these undiscounted cash flows are less than the carrying amounts of the assets, the Group records impairment losses to write the asset down to fair value, measured by the discounted estimated net future cash flows expected to be generated from the assets.

Investments

Investments in businesses in which the Group does not have control, but exercises significant influence over operating and financial policies ("affiliates"), are accounted for using the equity method.

Investments in corporate shares where the Group does not have the ability or intent to control or exercise significant influence over operating and financial policies are accounted for at cost of acquisition. Management periodically assesses the ability to recover the carrying values of such

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investments and records an impairment loss if, based upon the expected undiscounted cash flows, such investment's carrying value will not be recovered. Any such impairment loss is based upon recording as a new carrying amount of the investment, the lesser of the historical carrying amount and the expected discounted future cash flows.

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

The Group's debt securities are classified as held to maturity as the Group has the ability and intent to hold the securities to maturity. The securities are recorded at amortized cost.

Deferred Finance Charges

Arrangement, commission, commitment and related legal fees paid to secure a firm commitment from lenders and other direct debt issuance costs incurred in connection with new borrowings are deferred and amortized over the expected terms of the related loans using the effective-interest method.

Income Taxes

Income taxes have been computed in accordance with the laws of the country of incorporation of respective companies included in the Group. In 2008 and 2007, general statutory income tax rates in the RF, Ukraine and Republic of Armenia were equal to 24%, 25% and 10%, respectively; effective January 1, 2009, income tax rate in Russia was reduced to 20%. Income tax rate on dividends paid within Russia was 9% in 2007, and can be reduced to nil% starting from January 1, 2008 subject to certain restrictions.

Deferred income taxes are accounted for under the asset and liability method and reflect the tax effect of all temporary differences between the tax basis of assets and liabilities and their reported amounts in the consolidated financial statements using enacted tax rates in effect for the year in which the difference is expected to reverse. A valuation allowance is provided for deferred tax assets if it is more likely than not that some portion or all of the deferred tax assets will not be realized.

On January 1, 2007, the Group adopted the provisions of the FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes – an interpretation of SFAS No. 109" ("FIN No. 48"). FIN No. 48 removes income taxes from the scope of SFAS No. 5, "Accounting for Contingencies", and creates a single model to address uncertainty in tax positions and prescribes the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN No. 48 also provides guidance on de-recognition, measurement and classification of tax positions, accounting for interest and penalties, disclosure and transition. The adoption of FIN No. 48 resulted in the cumulative effect debit adjustment to the retained earnings as of January 1, 2007 of approximately \$2.4 million.

Retirement Benefit and Social Security Costs

In Russia, all social contributions, including contributions to the pension fund, are included in the unified social tax ("UST") calculated by the application of a regressive rate from 26% to 2% of the annual gross remuneration of each employee. UST is allocated to three social funds, including the Pension Fund of the Russian Federation, where the rate of contributions vary from 20% to 2%, depending on the annual gross salary of each employee. UST contributions are expensed as incurred.

MGTS has historically offered its employees certain benefits upon and after retirement. The cost of such benefits includes current service costs and amortization of prior service costs. The expense is

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recognized during an employee's years of active service with the Group (see Note 19). The recognition of expense for retirement pension plans is significantly impacted by estimates made by management such as discount rates used to value certain liabilities, expected return on assets, future rates of compensation increase and other related assumptions. The Group accounts for pension plans in accordance with the requirements of SFAS No. 87, "Employers' Accounting for Pensions", SFAS No. 132R, "Employers' Disclosure about Pensions and Other Postretirement Benefits, an amendment of FASB Statements No. 87, 88 and 106" and SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans", an amendment of FASB Statements No. 87, 88, 106, and 132(R).

Advertising Costs

Advertising costs are expensed as incurred and are reflected as a component of operating expenses in the statements of operations (see Note 23).

Subscriber Acquisition Costs

Subscriber acquisition costs represent the direct costs incurred to connect each new subscriber including dealer's commissions. The Group expenses these costs as incurred.

Distributions to Shareholders

Dividends are recognized at the date they are declared. Distributable retained earnings of the Group are based on amounts extracted from statutory accounts of Comstar UTS and may differ from amounts calculated on the basis of US GAAP (see Note 21).

Earnings Per Share (EPS)

Basic earnings per share is computed on the basis of the weighted average number of common shares outstanding. Diluted earnings per share is computed on the basis of the weighted average number of common shares outstanding plus the effect of the call and put option using the treasury stock method. Net income available to Comstar UTS's shareholders for each period is divided by the weighted average number of common shares outstanding during the respective period.

Stock-Based Compensation

The Group accounts for stock-based compensation in accordance with provisions of SFAS No. 123R (revised 2004), "Share-Based Payment". Under SFAS No. 123R, the Group calculates the cost of equity instruments, such as stock options or restricted stock, awarded to employees for services received using fair value method of accounting and recognizes such amounts in the income statement. The cost of the equity-based awards is measured based on the fair value of the instruments using a Black-Scholes option pricing model or Monte-Carlo simulation model, whichever is more appropriate, and is recognized on a straight-line basis over the vesting period of the award. Stock-based compensation expense includes the estimated effects of forfeitures. Such estimates are adjusted over the requisite service period to the extent actual forfeitures differ, or are expected to differ from such estimates. Changes in estimated forfeitures are recognized in the period of change and also impact the amount of expense to be recognized in future periods.

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Derivative Financial Instruments

The derivatives were initially recognized at fair values at the date the Group entered into the contracts. A derivative with a positive fair value is recognized as a financial asset whereas a derivative with a negative fair value is recognized as a financial liability. Such financial assets and liabilities are remeasured to their fair values at each balance sheet date. The resulting gain or loss is recognized in net income immediately.

The Group accounts for the call and put option granted in connection with acquisition of 25% plus one share stake in Svyazinvest (see Note 18) in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", as amended, and SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity".

The Group accounts for the call option acquired to limit the Group's exposure under the employee phantom option program (see Note 18) in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", as amended, and EITF Issue No. 00-19, "Accounting for derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock".

The call option derivative is presented as a non-current asset as the remaining maturity of the instrument is more than 12 months.

Debt

Debt issued by the Group is initially recorded based on proceeds received and is subsequently measured at amortized cost. Fair values of corporate bonds issued by MGTS are disclosed in Note 16. As of December 31, 2008, the fair value of other fixed rate debt, including capital lease obligations, and variable rate debt approximated carrying value.

Comparative Information

Certain prior year amounts and disclosures have been reclassified to conform to the 2008 presentation, including (i) separate presentation of goodwill from other intangible assets; (ii) combining of restricted cash, deferred tax assets, long-term portion and deferred finance charges, net of current portion under other non-current assets; (iii) separate presentation of payables to Sistema Hls from other long-term liabilities; (iv) exclusion of investments in equity of entities within the Group from segment assets; and (v) presentation of lines within deferred tax assets and liabilities categories.

Effects of Adopted Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS No. 157"). The standard provided guidance for using fair value to measure assets and liabilities and applies whenever other standards require (or permit) assets or liabilities to be measured at fair value. The standard did not expand the use of fair value in any new circumstances. SFAS No. 157 was effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The adoption of SFAS No. 157 had no material effect on the Group's financial statements.

SFAS No. 157 also establishes a hierarchy that classifies the inputs used to measure fair value. This hierarchy prioritizes the use of inputs to the valuation techniques into three levels based on observable and unobservable inputs. Unobservable inputs are inputs that market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of the Group. Unobservable inputs, which require more judgment, are those inputs described above that reflect management's assumptions about the assumptions market participants would use in pricing the asset or

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liability developed based on the best information available in the circumstances. The hierarchy is broken down into the three levels based on the reliability of inputs.

As of December 31, 2008 the only Group's assets and liabilities which are measured at fair value on a recurring basis comprised of derivative financial instruments (see Note 18).

In February 2008, the FASB issued FSP FAS 157-2, "Effective Date of FASB Statement No. 157" ("FSP FAS 157-2"). FSP FAS 157-2 delays the application of SFAS No. 157 for all non-financial assets and liabilities that are measured at fair value on a non-recurring basis. FSP FAS 157-3 is effective for interim and annual periods beginning after November 15, 2008. Therefore, in accordance with the aforementioned FSP, the Group has only partially applied SFAS No. 157. Beginning January 1, 2009, the Group will also apply SFAS No. 157 to all non-financial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a non-recurring basis as required by SFAS No. 157.

In October 2008, the FASB issued FSP FAS 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active" ("FSP FAS 157-3"). FSP FAS 157-3 clarifies the application of SFAS No. 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. FSP FAS 157-3 was effective upon issuance, including prior periods for which financial statements have not been issued, and therefore was effective for the financial statements for the year ended December 31, 2008. The adoption of FSP FAS 157-3 had no material effect on the Group's financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS No. 159") – including an amendment of FASB Statement No. 115, which permits an entity to measure certain financial assets and financial liabilities at fair value. SFAS No. 159 offers an irrevocable option to carry the vast majority of financial assets and liabilities at fair value, with changes in fair value recorded in earnings (the fair value option, or FVO). The Statement's objective is to improve financial reporting by allowing entities to mitigate volatility in reported earnings caused by the measurement of related assets and liabilities using different attributes, without having to apply complex hedge accounting provisions. The Group adopted the provisions of SFAS No. 159 effective January 1, 2008. Management has decided not to designate any additional financial instruments to be accounted for at the fair value effective January 1, 2008 and therefore the adoption had no impact on the Group's financial statements.

New Accounting Pronouncements

In December 2007, the FASB issued SFAS No. 141 (Revised 2007), "Business Combinations" ("SFAS No. 141R"), which significantly changes the accounting for business combinations. Under SFAS No. 141R, an acquiring entity will be required to recognize all the assets acquired and liabilities assumed in a transaction at the acquisition-date fair value with limited exceptions. Adoption of SFAS No. 141R will change the accounting treatment for certain specific acquisition related items including: (1) expensing acquisition related costs as incurred; (2) valuing noncontrolling (minority) interests at fair value at the acquisition date; and (3) expensing restructuring costs associated with an acquired business. SFAS No. 141R also includes a substantial number of new disclosure requirements. SFAS No. 141R is to be applied prospectively to business combinations for which the acquisition date is on or after January 1, 2009. Retrospective application and early adoption of SFAS No. 141R is prohibited. Management believes that SFAS No. 141R will have an impact on the accounting for future business combinations once adopted but the effect cannot be quantified at the moment.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements" ("SFAS No. 160"), which establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS No.

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160 requires that a noncontrolling interest in a subsidiary (minority interest) is reported as equity in the consolidated financial statements separately from the parent company's equity. Among other requirements, this statement requires consolidated net income to include the amounts attributable to both the parent and the noncontrolling interest. This statement is effective on January 1, 2009. The adoption of SFAS No. 160 will result in the reclassification of minority interests to equity and presentation of net income and other comprehensive income gross of amounts attributable to minority shareholders of the subsidiaries of the Group.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities" ("SFAS No. 161"). The new standard requires enhanced disclosures about derivative instruments and hedging activities to enable investors to better understand their effects on an entity's financial statements. SFAS No. 161 becomes effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The adoption of SFAS No. 161 will result in additional disclosure of the Group's derivative financial instruments.

In April 2008, the FASB issued FASB Staff Position ("FSP") No. FAS 142-3, "Determination of the Useful Life of Intangible Assets" ("FSP No. 142-3"). FSP No. 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142. The objective of FSP No. 142-3 is to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141R and other US GAAP. FSP No. 142-3 applies to all intangible assets, whether acquired in a business combination or otherwise, and is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years and should be applied prospectively to intangible assets acquired after the effective date. Early adoption is prohibited. The Group expects FSP No. 142-3 will have an impact on its accounting for future acquisitions of intangible assets once adopted, but the effect is dependent upon the acquisitions that are made in the future.

In November 2008, the FASB issued EITF Issue No. 08-7, "Accounting for Defensive Intangible Assets" ("EITF Issue No. 08-7"). EITF Issue No. 08-7 applies to all acquired intangible assets in situations in which an entity does not intend to actively use the asset but intends to hold (lock up) the asset to prevent others from obtaining access to the asset (a defensive intangible asset), except for intangible assets that are used in research and development activities. The EITF reached a consensus that a defensive intangible asset should be accounted for as a separate unit of accounting and should be assigned a useful life that reflects the entity's consumption of the expected benefits related to the asset, noting that it would be rare for a defensive intangible asset to have an indefinite life. This EITF Issue No. 08-7 is effective for intangible assets acquired on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Group expects EITF Issue No. 08-7 will have an impact on its accounting for future acquisitions of intangible assets once adopted, but the effect is dependent upon the acquisitions that are made in the future.

In December 2008, the FASB issued FSP No. 132(R)-1, "Employers' Disclosure about Postretirement Benefit Plan Assets." This FSP provides guidance on an employer's disclosures regarding plan assets of a defined benefit pension or other postretirement plan. The objectives of the disclosures required under this FSP are to provide users of financial statements with an understanding of (a) how investment allocation decisions are made; (b) the major categories of plan assets; (c) the inputs and valuation techniques used to measure the fair value of plan assets; (d) the effect of fair value measurements using significant unobservable inputs on changes in plan assets for the period; and (e) significant concentrations of risk within plan assets. The disclosures about plan assets required by this FSP are required for fiscal years ending after December 15, 2009, and earlier application is permitted. This FSP is not expected to have a material impact on the Group's financial statements.

OJSC COMSTAR UTS AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEARS ENDED DECEMBER 31, 2008 and 2007 (Amounts in thousands of US dollars, unless otherwise stated)

3. ACQUISITIONS AND DISPOSALS OF SUBSIDIARIES AND AFFILIATES

Acquisitions of controlling interests in regional fixed line operators

In 2008 and 2007, as a part of its program of regional expansion, the Group has acquired controlling interests in a number of alternative fixed-line operators in certain regions of Russia and additional interests in the existing subsidiaries. Purchase price for all of these acquisitions was paid in cash. The acquisitions were accounted for using the purchase method of accounting except for the acquisition of an additional interest in Golden Line which was accounted for as a common control transaction.

The following table summarizes the purchase price allocation of the companies acquired during the year ended December 31, 2008:

	Interlink Group	Strategia (Urals Telephone Company ("UTC"))	Total
Month of acquisition	June	July	
Ownership interest acquired	100%	100%	
Region of operations	Ryazan region	Sverdlovsk region	
Current assets	\$ 994	\$ 4,571	\$ 5,565
Property, plant and equipment	3,075	7,796	10,871
Subscriber base	9,598	56,667	66,265
Current liabilities	(2,057)	(6,990)	(9,047)
Non-current liabilities	(3,182)	(18,559)	(21,741)
Purchase price	\$ 8,428	\$ 43,485	\$ 51,913

The purchase price allocation of Intersvyazservice and Inter-TV Media (collectively referred to as "Interlink Group") and UTC has not been finalized as of the date of these financial statements, as Group has not completed valuation of individual assets of these companies. The Group's financial statements reflect the allocation of the purchase price based on a preliminary fair value assessment of the assets acquired and liabilities assumed. Subscriber base is amortized over a 10-year period.

The following table summarizes the purchase price allocation of the companies acquired during the year ended December 31, 2007:

	Sochitelecom-service	DTN	RTC	Comstar Ukraine (*)	Total
Month of acquisition	August	November	December	May	
Ownership interest acquired	100%	100%	88%	25%	
Region of operations	Krasnodar region	Rostov region	Khanty Mansiisk and Orenburg Regions	Ukraine	
Current assets	\$ 51	\$ 10,977	\$ 13,421	\$ —	\$ 24,449
Property, plant and equipment	114	102,558	21,402	—	124,074
Subscriber base	232	91,923	738	—	92,893
Trademark	—	1,683	—	—	1,683
Goodwill	451	—	—	543	994
Current liabilities	(98)	(6,873)	(3,949)	—	(10,920)
Non-current liabilities	—	(33,112)	(3,377)	—	(36,489)
Minority interests	—	—	(2,109)	424	(1,685)
Purchase price	\$ 750	\$ 167,156	\$ 26,126	\$ 967	\$ 194,999

(*) Acquisition of an additional 25% interest in the existing subsidiary, Comstar Ukraine, resulting in 100% ownership as of December 31, 2007.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEARS ENDED DECEMBER 31, 2008 and 2007 (Amounts in thousands of US dollars, unless otherwise stated)

Recognition of goodwill in the amounts of \$0.5 million and \$0.5 million from the acquisition of Sochitelecomservice and Comstar Ukraine, respectively, was due to economic potential of the markets the acquired companies operate in. Goodwill was recognized in the Alternative Segment in the Regions and the CIS business segment.

The Group's financial statements reflect the allocation of the purchase price based on a fair value assessment of the assets acquired and liabilities assumed. The excess purchase price over the fair value of the net assets acquired of approximately \$1.0 million has been assigned to goodwill which is not deductible for tax purposes. Subscriber base components are amortized over the periods ranging from 13 to 24 years, depending on the type of subscribers. Other intangible assets primarily represent a trademark.

Disposal of shares in Metrocom

In March 2007, Comstar UTS sold its 45% stake in Metrocom, an affiliate of the Group, to a third party for a total cash consideration of \$20.0 million, resulting in a gain of \$3.2 million recognized in the accompanying consolidated income statement for the year ended December 31, 2007.

Acquisition of minority interest in Golden Line

In April 2007, as a part of a reorganization of the Group, Comstar UTS acquired 100% shares in Golden Line from Comstar-Direct, a 52%-owned subsidiary of the Group, thus increasing its effective shareholding in Golden Line to 100%. The acquisition has been accounted for as a common control transaction, at carrying amounts with excess of the book value of the net assets acquired over the purchase price, net of income taxes, recorded as an increase in the additional paid-in capital of the Group in the amount of \$2.8 million, net of tax of \$2.0 million.

Pro-forma results of operations (unaudited)

The following pro-forma financial data for the years ended December 31, 2008 and 2007 give effect to the acquisition of subsidiaries and minority interests discussed above as if they had occurred as of January 1, 2007:

	<u>2008</u>	<u>2007</u>
Operating revenues	\$ 1,676,961	\$ 1,587,364
Operating income.....	499,883	493,847
Net income.....	180,960	68,070
Earnings per share		
Basic	0.45	0.19
Diluted	0.42	0.18

The pro-forma information is based on various assumptions and estimates and is not necessarily indicative of the operating results that would have occurred if the Group's acquisitions had been consummated at the beginning of the respective period, nor is it necessarily indicative of future operating results. The pro-forma information does not give effect to any potential revenue enhancements or cost synergies or other operating efficiencies that could result from the acquisitions.

Reorganization of Comstar-Direct

Prior to December 2008, Comstar-Direct was owned 52% by the Group and 48% by Sistema Mass Media ("SMM"), a subsidiary of Sistema. In December 2008, Comstar-Direct, a subsidiary of the Group, was split into two legal entities: SMM-Finance which became a 100% subsidiary of SMM,

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEARS ENDED DECEMBER 31, 2008 and 2007 (Amounts in thousands of US dollars, unless otherwise stated)

and Comstar-Direct which became a 100% subsidiary of Comstar UTS. The effect of this transaction was the disposal of \$26.8 million of net assets of Comstar-Direct and the Group's acquisition of the remaining 48% minority interest in Comstar-Direct from SMM. The transaction was accounted for at cost as a transaction between entities under common control. The excess of the net assets disposed of and the minority interest acquired was recorded in additional paid-in capital.

Summary of the assets and liabilities disposed of by the Group and the acquisition of the remaining 48% minority interest in Comstar-Direct is as follows:

Cash and short-term investments and loans.....	\$	5,029
Inventory and other current assets		6,168
Trade and other accounts receivable.....		22,379
Long-term investments and loans		7,508
Trade accounts payable.....		(14,264)
Total assets and liabilities disposed, net.....	\$	26,820
Minority interest acquired.....		(15,813)
Excess of the net assets disposed of and minority interest acquired	\$	11,007

4. CASH AND CASH EQUIVALENTS

Cash and cash equivalents as of December 31, 2008 and 2007 consisted of the following:

	<u>2008</u>	<u>2007</u>
Cash	\$ 32,620	\$ 82,992
Cash equivalents:		
Promissory notes of MBRD	—	32,592
Demand deposits	—	63,964
Other.....	90	246
Total	\$ 32,710	\$ 179,794

Cash and cash equivalents with the Moscow Bank of Reconstruction and Development ("MBRD"), a subsidiary of Sistema, as of December 31, 2008 and 2007 amounted to \$24.0 million and \$66.8 million, respectively. Interest income earned on cash and cash equivalents and short-term investments in MBRD is disclosed in Note 26.

OJSC COMSTAR UTS AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEARS ENDED DECEMBER 31, 2008 and 2007 (Amounts in thousands of US dollars, unless otherwise stated)

5. SHORT-TERM INVESTMENTS AND LOANS

Short-term investments and loans as of December 31, 2008 and 2007 consisted of the following:

	Interest rate at December 31, 2008	2008	2007
RUR-denominated time deposits	—	\$ —	\$ 414
USD-denominated time deposits	—	—	10,005
RUR-denominated promissory notes	—	—	40,129
Funds transferred to the investment broker	nil	11,981	95,821
Promissory notes of and loans to other subsidiaries and affiliates of Sistema:			
Alt (see Note 26)	18%	85,091	—
Delfa (see Note 26)	18%	68,073	—
Finexkort (see Note 26)	16.5%	68,073	—
Sky Link (see Note 26)	11%	9,394	12,741
Sistema Hals (see Note 26)	11%	16,688	19,975
Remstroytrest (see Note 26)	—	—	37,196
Stream TV (see Note 26)	13%	34,822	—
MBRD	—	—	209,648
	not less than		
Funds in trust management by MBRD	10%	45,949	—
Currency forward contracts with MBRD (Note 18)	N/A	9,734	—
Other short-term investments and loans	various	165	—
Total		\$ 349,970	\$ 425,929

Interest income earned on short-term investments in and loans to related parties is disclosed in Note 26.

In 2007, the Group transferred RUR 2,352.0 million (approximately \$80.1 million as of December 31, 2008) in cash to an investment broker as part of a planned acquisition of a telecommunication company. Due to the changes in market conditions, the transaction was not completed. The deposit was partially returned in cash in 2008, the remainder was returned in cash in the first quarter of 2009.

In 2006, the management of Sky Link, an affiliate of Sistema, started negotiations to extend the term of the repayment of certain receivables, loans and notes, the majority of which were past due as of December 31, 2006. In 2007, an agreement was reached in respect of such receivables, loans and notes totalling \$29.5 million as of December 31, 2007, which shall be repaid by Sky Link, together with interest charged at 10% and 11% p.a., depending on the instrument, on various dates in 2008 and 2009. Substantially all instruments are denominated in the USD. The negotiations in respect of the remaining portion of Skylink promissory notes and loans have not yet resulted in a firm repayment schedule. Due to historically experienced delays in payments as they become due and requests to extend maturity of the amounts owed made by Sky Link over the last several years, management believes that recoverability of the long-term portion of Sky Link debt is doubtful in the foreseeable future. Accordingly, in 2007 management has recorded a provision for impairment of the long-term

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEARS ENDED DECEMBER 31, 2008 and 2007 (Amounts in thousands of US dollars, unless otherwise stated)

portion of Sky Link debt for the amount of \$21.1 million. As of the date of these financial statements, Sky Link completely redeemed the amount outstanding as of December 31, 2008.

In 2007, the Group has granted a RUR 490.3 million (approximately \$16.7 million as of December 31, 2008) RUR-denominated loan to Sistema Hals, a subsidiary of Sistema. The loan bears interest at 11% per annum and matures in December 2009. Effective January 1, 2009 interest rate on the loan was increased to 16% per annum.

In 2008, the Group has made a series of loans totaling RUR 1,023.1 million (approximately \$34.8 million as of December 31, 2008) to Stream TV, a subsidiary of Sistema (see Note 13). The loans mature in on various dates in 2009.

In 2008, the Group transferred RUR 1,350.0 million (approximately \$45.9 million as of December 31, 2008) into a trust managed by MBRD, a subsidiary of Sistema. MBRD guaranteed income of not less than 10% per annum on these amounts. In March 2009, this amount together with income accrued to date was withdrawn by the Group.

In December, the Group has purchased promissory notes of Alt, Delfa and Finexcort, affiliates of Sistema, for the total amount of RUR 6,500.0 million (approximately \$221.2 million as of December 31, 2008). The notes, together with interest accrued, were redeemed in the first quarter of 2009.

6. TRADE RECEIVABLES, NET

Trade receivables, net of provision for doubtful debts, as of December 31, 2008 and 2007 consisted of the following:

	<u>2008</u>	<u>2007</u>
Receivables from corporate subscribers and operators	\$ 127,201	\$ 130,768
Receivables from individual subscribers	48,915	55,677
Provision for doubtful receivables	(18,627)	(23,417)
Total	\$ 157,489	\$ 163,028

7. OTHER RECEIVABLES, PREPAID EXPENSES AND OTHER CURRENT ASSETS

Other receivables, prepaid expenses and other current assets as of December 31, 2008 and 2007 consisted of the following:

	<u>2008</u>	<u>2007</u>
VAT recoverable	\$ 25,288	\$ 28,124
Prepaid taxes	22,998	23,769
Prepayments	9,349	16,301
Other receivables	12,789	33,474
Deferred finance charges, current portion (see Note 16)	332	—
Total	\$ 70,756	\$ 101,668

OJSC COMSTAR UTS AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEARS ENDED DECEMBER 31, 2008 and 2007 (Amounts in thousands of US dollars, unless otherwise stated)

8. INVENTORIES AND SPARE PARTS

Inventories and spare parts as of December 31, 2008 and 2007 consisted of the following:

	<u>2008</u>	<u>2007</u>
Equipment for resale.....	\$ 6,961	\$ 16,978
Spare parts and other materials.....	18,205	24,350
Total	\$ <u>25,166</u>	\$ <u>41,328</u>

9. GOODWILL

The changes in the carrying amount of goodwill for 2008 and 2007 are as follows:

	<u>Total</u>
Balance at December 31, 2006	\$ 3,459
Acquisitions (Note 3).....	994
Impairments	(827)
Currency translation.....	583
Balance at December 31, 2007	\$ 4,209
Currency translation.....	(692)
Balance at December 31, 2008	\$ <u>3,517</u>

The Group performed the annual impairment test of goodwill as of December 31, 2008 in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets", which did not result in an impairment of goodwill.

10. PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment, net of accumulated depreciation, as of December 31, 2008 and 2007 consisted of the following:

	<u>2008</u>	<u>2007</u>
Buildings and constructions.....	\$ 393,770	\$ 384,990
Telecommunications equipment and cable.....	1,565,749	1,468,033
Other fixed assets.....	246,464	303,071
Construction in-progress and equipment for installation.....	189,628	365,080
Property, plant and equipment, at cost, total.....	<u>2,395,611</u>	<u>2,521,174</u>
Less: accumulated depreciation.....	(595,483)	(614,062)
Property, plant and equipment, net	\$ <u>1,800,128</u>	\$ <u>1,907,112</u>

The depreciation charge for the years ended December 31, 2008 and 2007, net of amortization of property, plant and equipment contributions (see Note 20) and including depreciation of assets in the capital lease (see Note 17), amounted to \$153.6 million and \$145.5 million, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEARS ENDED DECEMBER 31, 2008 and 2007 (Amounts in thousands of US dollars, unless otherwise stated)

11. INTANGIBLE ASSETS, NET

Intangible assets, net of accumulated amortization, as of December 31, 2008 and 2007 consisted of the following:

	Weighted average amorti- zation period, years	2008			2007		
		Gross carrying value	Accu- mulated amorti- zation	Net carrying value	Gross carrying value	Accu- mulated amorti- zation	Net carrying value
Billing systems and other software	6	\$ 119,700	\$ (72,296)	\$ 47,404	\$ 124,702	\$ (62,717)	\$ 61,985
Customer base	17	140,142	(7,960)	132,182	106,751	(6,467)	100,284
Licenses	2	11,860	(8,700)	3,160	13,128	(4,180)	8,948
TV content	6	548	(230)	318	1,420	(543)	877
Other	4	20,383	(4,512)	15,871	23,042	(8,339)	14,703
Total intangible assets	8	\$ 292,633	\$ (93,698)	\$ 198,935	\$ 269,043	\$ (82,246)	\$ 186,797

Amortization expense recorded on intangible assets for the years ended December 31, 2008 and 2007 amounted to \$42.1 million and \$32.4 million, respectively. Based on the intangible assets existing at December 31, 2008, the estimated amortization expense for each of the five succeeding years is as follows: 2009 – \$28.6 million; 2010 – \$23.6 million; 2011 – \$19.9 million; 2012 – \$14.5 million and 2013 – \$11.7 million. Actual amortization expense to be reported in future periods could differ from these estimates as a result of new intangible assets acquisitions, changes in useful lives, changes in exchange rates and other relevant factors.

12. INVESTMENT IN SHARES OF SVYAZINVEST

In December 2006, as a part of its program of regional expansion, the Group acquired a 25% stake plus one share in Telecommunication Investment Joint Stock Company (“Svyazinvest”) from Mustcom Limited for a total consideration of approximately \$1,390.0 million, including cash of \$1,300.0 million and the fair value of the call and put option of \$90.0 million (see Note 18). In a series of transactions, Comstar UTS and MGTS Finance S.A., a subsidiary of MGTS, have acquired 4,879,584,306 ordinary shares of Svyazinvest, with Comstar UTS buying 3,378,173,750 shares, which represent 17.3% of total outstanding shares of Svyazinvest, and MGTS Finance S.A. buying 1,501,410,556 shares, representing 7.7% of total outstanding shares of Svyazinvest. Svyazinvest is a holding company that holds controlling stakes in seven publicly traded incumbent fixed-line operators (“MRKs”) based in all seven Federal districts of Russia, Rostelecom, a publicly traded long-distance fixed-line operator operating a Russia-wide network, and several other entities, the majority of which are non-public.

Based on the analysis of all relevant factors, the management determined that the acquisition of 25% plus one share of Svyazinvest does not allow the Group to exercise significant influence over this entity due to the legal structure of Svyazinvest and certain limitations imposed by Svyazinvest charter documents. Accordingly, the Group accounts for its investment in Svyazinvest under the cost method.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEARS ENDED DECEMBER 31, 2008 and 2007 *(Amounts in thousands of US dollars, unless otherwise stated)*

At December 31, 2008, the carrying value of the investment was \$1,241.0 million (RUR 36,460.4 million). Given the economic downturn in Russia and the global economy and the volatility in the markets described in Note 1, management determined that as of December 31, 2008 there were potential indicators of impairment of this investment. As management does not have access to underlying financial data of Svyazinvest, it does not believe it is able to accurately determine the fair value of the investment. In order to assess the investment for a potential impairment, the Group aggregated market value of Svyazinvest's holdings in its publicly traded subsidiaries which totaled \$823.4 million (RUR 24,190.9 million) at December 31, 2008 and \$1,021.6 million (RUR 34,514.5 million) at April 24, 2009. These amounts exclude the value of Svyazinvest's non-public holdings, as well as any control premium or the effect of bringing the assets together under Svyazinvest. In addition, management has reviewed relevant publicly available information relating to Svyazinvest, including Svyazinvest and its subsidiaries' news releases, analyst reports and share price data for its publicly-traded subsidiaries. On the basis of this information and the significant increase in value of the public entities subsequent to December 31, 2008, management has determined that its investment is not other than temporarily impaired.

Management continues to consider various options with respect to the Group's stake in Svyazinvest, including but not limited to sale or non-monetary exchange of the stake. Accordingly, there remains an uncertainty as to how the value of Svyazinvest stake will be realized by the Group. Future events, additional information regarding the fair value of the investment or a disposal transaction involving Svyazinvest investment could result in recognition of impairment of the carrying value of the Group's investment in Svyazinvest in future periods.

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13. OTHER LONG-TERM INVESTMENTS AND LOANS

Other long-term investments and loans as of December 31, 2008 and 2007 consisted of the following:

	2008		2007	
	Ownership, %	Investment	Ownership, %	Investment
Prepayment to SMM for the 2009 acquisition of Stream TV (see Note 30)		\$ 117,110		\$ —
Investments in shares				
MBRD (see Note 26)	4.56%	5,402	4.56%	6,466
SMM (see Note 26)	3.14%	3,970	3.14%	4,751
TS-Retail (see Note 26)	15%	—	15%	2,105
Coral-Sistema Strategic Fund (see Note 26)	10%	2,966	10%	860
Other	various	1,431	various	1,127
Total investments in shares		13,769		15,309
Other investments and loans				
Promissory notes of Sistema Telecom, a subsidiary of Sistema (see Note 26)		51,966		58,319
Advance to the Moscow City Government		9,360		11,203
Loan to Intellect Telecom, a subsidiary of Sistema (see Note 26) ...		6,315		6,355
Loan to Ruslan TV, a subsidiary of Stream TV (see Note 26)		30,633		—
Input VAT recognized on transactions with Sistema Hals within MGTS investment program (see Note 26, 27 and 30)		5,614		4,700
Other		3,399		3,845
Total other investments and loans		107,287		84,422
Grand total		\$ 238,166		\$ 99,731

In the third and the fourth quarters of 2008, the Group, under the management agreement with SMM, received a right to manage SMM equity interest in Stream TV, provided financing to Stream TV in the amount of \$65.4 million (see also Note 5 and 26) and guaranteed certain liabilities of Stream TV to third parties (see Note 27). In December 2008, the Group entered into an agreement with SMM to acquire all of SMM's interest in certain of its subsidiaries (collectively referred to as "Stream TV") for a total cash consideration of RUR 3,544.5 million (approximately \$120.6 million as of December 31, 2008), determined by an independent appraiser and payable in installments between December 2008 and March 2009. RUR 3,440.8 million (approximately \$117.1 million as of December 31, 2008) of the consideration was paid before December 31, 2008. As of December 31, 2008 the transfer of legal title and all risk and rewards of ownership had not yet been finalized (see Note 30).

In October 2007, the Group contributed an office building with net book value of \$4.8 million in the charter capital of SMM, a subsidiary of Sistema, in exchange for 3.14% share ownership.

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In September 2007, the Group invested \$2.1 million in cash in TS-Retail, a retail start-up jointly owned by several subsidiaries of Sistema. The Group is using TS-Retail as one of its distribution channels. In December 2008, the Group recognized a full impairment of this investment of \$1.9 million due to high degree of risk inherent to the future cash flows associated with this investment.

In 2007 and 2008, the Group made cash investments of \$0.9 million and \$2.0 million, respectively in Coral-Sistema Strategic Fund (CSSF), a limited liability partnership owned by Sistema and several of its subsidiaries which is managed by Coral Capital Management. The Group is committed to invest a further \$3.7 million in CSSF. CSSF is investing in companies with strategic value to Comstar UTS and other subsidiaries of Sistema. The Group does not exercise significant influence over CSSF and therefore accounts for this investment at cost.

Promissory notes of Sistema Telecom, a subsidiary of Sistema, include \$30.4 million of RUR-denominated notes, which bear interest of 4.4% per annum, and \$21.6 million of USD-denominated notes, which bear interest of 3% per annum. The notes mature on various dates in 2009, however, as of the date of these financial statements management expects that the maturity of a significant portion of these notes will be extended. Accordingly, they are classified as long-term investments and loans in the accompanying consolidated balance sheet as of December 31, 2008. Interest income earned on investments in Sistema Telecom's promissory notes is disclosed in Note 26.

In connection with the long-term program of digitalization of MGTS' network (see Note 26) and planned renovation and disposal of certain MGTS' buildings, during the fourth quarter of 2005, MGTS made an advance payment of RUR 275.0 million (\$9.4 million as of December 31, 2008) to the Moscow City Government, which will be offset against the future liability of MGTS to provide the Moscow City Government with its share in the buildings when their reconstruction is complete.

In July 2007, MGTS granted a RUR 156.0 million (\$6.3 million as of December 31, 2008) loan to Intellect Telecom, a subsidiary of Sistema. The loan bears interest at 7% per annum and is repayable in 2012.

In 2008, Comstar UTS granted a RUR 900.0 million (\$30.6 million as of December 31, 2008) loan to Ruslan TV, a subsidiary of Stream TV. The loan bears interest at 11.3% per annum and is repayable in 2010.

14. OTHER NON-CURRENT ASSETS

Other non-current assets as of December 31, 2008 and 2007 consisted of the following:

	<u>2008</u>	<u>2007</u>
Purchased call option (see Note 18)	\$ 5,830	\$ —
Restricted cash	—	2,447
Deferred tax assets, long-term portion (see Note 24)	841	1,631
Deferred finance charges, net of current portion (see Note 16)	479	1,375
Total	\$ 7,150	\$ 5,453

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEARS ENDED DECEMBER 31, 2008 and 2007 (Amounts in thousands of US dollars, unless otherwise stated)

15. TRADE ACCOUNTS PAYABLE, ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

Trade accounts payable, accrued expenses and other current liabilities as of December 31, 2008 and 2007 consisted of the following:

		<u>2008</u>		<u>2007</u>
Trade accounts payable.....	\$	90,053	\$	56,580
Accrued payroll		36,620		48,068
Taxes payable		29,452		26,772
Accounts payable for the acquisition of property, plant and equipment.....		60,108		20,830
Liability under employee stock option program (see Note 28).....		—		10,948
Accrued interest		2,740		1,775
Dividends payable		561		893
Other current liabilities		9,443		13,088
Total	\$	<u>228,977</u>	\$	<u>178,954</u>

16. DEBT OBLIGATIONS

The Group's debt obligations as of December 31, 2008 and 2007 consisted of the following:

	<u>Currency</u>	<u>Annual interest rate (actual at December 31, 2008)</u>	<u>2008</u>	<u>2007</u>
MGTS Bonds 4 th issue	RUR	7.1%	\$ 5,233	\$ 29,338
MGTS Bonds 5 th issue	RUR	7.1%	5,202	59,903
Sberbank credit line facility	RUR	9.5%	884,944	877,689
Access Telecommunications Cooperatief U.A.....	USD	16.0%	263,552	—
Ruslan TV	RUR	11.3%	30,633	—
MBRD	Euro	EURIBOR + 2.75% (5.70%)	1,503	2,183
VTB	Euro	5.0% (6.70%)	7,614	18,984
Commerzbank.....	Euro	4.0%	1,299	2,247
Vendor financing	various	various	1,267	3,158
Other	various	0%–15.75%	7,389	1,295
Total debt.....			<u>1,208,636</u>	<u>994,797</u>
Less: amounts maturing within one year			<u>(426,681)</u>	<u>(103,476)</u>
Debt, net of current portion			\$ <u>781,955</u>	\$ <u>891,321</u>

OJSC COMSTAR UTS AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEARS ENDED DECEMBER 31, 2008 and 2007 (Amounts in thousands of US dollars, unless otherwise stated)

Corporate bonds

In April 2004, MGTS issued 5-year RUR-denominated bonds (fourth issue) with the face value of RUR 1,500 million (equivalent to \$51.1 million as of December 31, 2008). The bonds carried a coupon of 10.0% per annum, which was decreased to 7.1% per annum in April 2006. Interest is paid semi-annually. MGTS made unconditional offers to repurchase the bonds at par value in April 2006, 2007 and 2008, which were exercised in the amounts of approximately \$30.1 million, \$0.2 million and \$24.1 million, respectively.

In May 2005, MGTS issued 5-year RUR-denominated bonds (fifth issue) with a face value of RUR 1,500 million (equivalent to \$51.1 million as of December 31, 2008). The bonds carried a coupon of 8.3% per annum during the two years ending April 2007, and carries a coupon of 7.1% per annum further until May 2009, at which date the interest rate will be re-set at management discretion. Interest is paid semi-annually. In June 2006 and the second quarter of 2008, the Group repurchased the bonds at par value for the amount of \$0.6 million and \$55.5 million, respectively.

Currently, MGTS has an unconditional outstanding offer to repurchase the fourth and the fifth issues of the bonds at par in April and May 2009, respectively. Accordingly, both issues are classified as current liabilities in the accompanying consolidated balance sheet as of December 31, 2008.

As of December 31, 2008, the total fair value of the outstanding bonds was approximately \$11.3 million.

Sberbank Credit Line Facility

In June 2007, Comstar UTS entered into a non-revolving credit line facility with Sberbank for the amount of RUR 26.0 billion (equivalent of \$1,059.2 million as of December 31, 2007). In June 2007, Comstar UTS has drawn down approximately RUR 17.4 billion (equivalent of \$675.0 million as of the date of the drawdown) under this facility and used the proceeds to repay a \$675.0 million loan from ABN Amro and Morgan Stanley. In November 2007, Comstar UTS has drawn additional RUR 4.1 billion (equivalent of \$167.4 million as of the date of the drawdown) under this facility to finance the acquisition of a 100% stake in DTN (see Note 3). In December 2008, Comstar UTS has drawn the remaining RUR 4.5 billion to finance the anticipated acquisition of Stream TV (see Note 13 and 30). Accordingly, as of December 31, 2008 the facility was fully drawn. The facility originally bore interest at 7.6% per annum, which can be increased by Sberbank in conjunction with, but not exclusively, increases in Central Bank of Russia refinancing rate. Interest rate was increased to 9.5% per annum effective June 28, 2008, and further to 13.35% effective January 1, 2009. Interest is paid monthly. The facility is repayable in equal quarterly installments from September 2009 until June 2012 and is secured by a pledge of a 25% plus one share stake in Svyazinvest (see Note 12). Deferred financing costs of approximately \$1.5 million were capitalized in connection with this facility (see Notes 7 and 14).

Access Telecommunications Cooperatief U.A.

In November 2008, MGTS Finance S.A. issued Access Telecommunications Cooperatief U.A. ("Access") a \$363.6 million USD-denominated promissory note as part payment of its obligation under the put option (see Note 18). Of this amount, \$100.0 million was repaid in December 2008, and remaining \$263.6 million is repayable in the first quarter of 2009 in monthly installments. The note bears interest at 16% per annum and is guaranteed by Sistema and Comstar UTS, which liabilities are limited to \$230.0 million and \$69.0 million, respectively. Interest is paid monthly. As of December 31, 2008, Comstar UTS shares acquired during exercise of the put option were pledged to secure this liability. The pledge was terminated in January 2009. As of the date of these financial statements, the Group has fully repaid the amounts due to Access.

OJSC COMSTAR UTS AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued) **FOR THE YEARS ENDED DECEMBER 31, 2008 and 2007** *(Amounts in thousands of US dollars, unless otherwise stated)*

Ruslan TV

In December 2008, MGTS entered into a loan agreement with Ruslan TV, a subsidiary of Stream TV (see Note 13), for an amount of RUR 900 million (equivalent of \$30.6 million as of December 31, 2008). The loan bears interest at 11.3% and matures in 2010. Interest is paid monthly.

MBRD

In July 2006, MGTS entered into a loan agreement with MBRD for an amount of Euro 2.1 million (equivalent of \$3.0 million as of December 31, 2008) to finance the acquisition of equipment. The loan is repayable in equal semi-annual installments in 2006-2011 and bears interest at EURIBOR+2.75% per annum (5.70% as of December 31, 2008). Interest is paid semi-annually.

VTB

In January 2006, MGTS entered into a credit agreement with VTB bank for an amount of Euro 7.7 million (equivalent of \$10.9 million as of December 31, 2008) to finance the acquisition of equipment. The loan matures in January 2012 and bears interest at EURIBOR+5.0% per annum (6.70% as of December 31, 2008). Interest is paid semi-annually. As of December 31, 2008, the amount outstanding under the agreement was \$7.6 million.

In March 2005, MGTS entered into a credit agreement with VTB for an amount of Euro 5.3 million (equivalent of \$7.5 million as of December 31, 2008) to finance the acquisition of equipment. In 2008, MGTS fully repaid this loan ahead of schedule.

In July 2004, MGTS entered into two credit agreements for a total amount of Euro 7.3 million (equivalent of \$10.3 million as of December 31, 2008) to finance the acquisition of equipment. In 2008, MGTS fully repaid these loans ahead of schedule.

Commerzbank

In December 2004, Sistema Multimedia (subsequently merged into MTU-Intel which was then renamed to Comstar-Direct) entered into a credit facility agreement with Commerzbank for Euro 5.5 million (equivalent of \$7.8 million as of December 31, 2008). The loan bears interest at 4.0% per annum and matures in 2010. Interest is paid semi-annually.

Vendor financing

Suppliers of telecommunications equipment provide uncollateralized commercial credit to the Group denominated in various currencies on the short-term and long-term basis.

OJSC COMSTAR UTS AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEARS ENDED DECEMBER 31, 2008 and 2007 (Amounts in thousands of US dollars, unless otherwise stated)

Debt Repayments Schedule

The debt principal repayments over future periods are as follows:

Year ended December 31,	
2009	426,681
2010	329,440
2011	299,121
2012	150,315
2013	3,079
Total	\$ 1,208,636

Compliance with Covenants and Other Restrictive Provisions

Sberbank credit line facility effective as of December 31, 2008 imposes certain covenants and restrictions on the Group, including but not limited to restrictions on Debt to Operating Income before Depreciation and Amortization ("OIBDA") ratio and reorganizations of Comstar UTS. Management believes that as of December 31, 2008, the Group is in compliance with all existing restrictive provisions and covenants of its debt obligations which could cause the technical default on the Group's obligations in case of non-compliance.

17. CAPITAL LEASE OBLIGATIONS

MGTS entered into several agreements for the lease of telecommunication equipment with InvestSvyazHolding, a subsidiary of Sistema. The agreements expire on various dates in 2008-2010 and provide for transfer of ownership of the equipment to the Group after the last lease payment is made. The interest rate implicit in the leases varies from 10% to 14%. Respective obligations are denominated in Euro. In addition to the agreements with InvestSvyazHolding, the Group has certain other leasing agreements with third parties; assets capitalized under these agreements and respective liabilities are not material.

The following is a summary of leased assets and respective depreciation as of December 31, 2008 and 2007:

	2008	2007
Gross book value of leased assets..... \$	69,282 \$	82,926
Accumulated depreciation	(22,874)	(20,318)
Net book value of leased assets	\$ 46,408	\$ 62,608

Depreciation of the assets recorded under capital leases is included in depreciation and amortization in the accompanying consolidated statements of operations. Interest expense accrued on capital lease obligations for the years ended December 31, 2008 and 2007 amounted to \$1.1 million and \$2.4 million, respectively.

OJSC COMSTAR UTS AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEARS ENDED DECEMBER 31, 2008 and 2007 (Amounts in thousands of US dollars, unless otherwise stated)

The following table presents future minimum lease payments under capital leases together with the present value of the net minimum lease payments as of December 31, 2008:

Year ended December 31,		
2009	\$	5,788
2010		1,026
2011		22
Total minimum lease payments (undiscounted)		6,836
Less: amount representing interest		(300)
Total present value of net minimum lease payments.....	\$	6,536

18. DERIVATIVE FINANCIAL INSTRUMENTS

The Company reviews its fair value hierarchy classifications quarterly. Changes in significant observable valuation inputs identified during these reviews may trigger reclassification of fair value hierarchy levels of financial assets and liabilities. During the years ended December 31, 2008 and 2007, no such reclassifications occurred. Liability under the call and put option and asset under the purchased call option are measured using significant unobservable inputs (Level 3), while asset under the currency forward is measured using inputs other than quoted prices ("Level 2" Inputs of SFAS No. 157 hierarchy), including market value of forward contracts with similar maturities.

Written Call and Put Option

Simultaneously with the acquisition of the 25% stake plus one share in Svyazinvest (see Note 12), MGTS Finance S.A. and "2711 Centerville Cooperatief U.A." ("2711 UA"), an affiliate of Mustcom Limited, signed a call and put option agreement, which gives 2711 UA a right to purchase 46,232,000 shares of Comstar UTS, representing 11.06% of total issued shares, from MGTS Finance S.A and sell them back to MGTS Finance S.A. The call option acquired by 2711 UA could be exercised at a strike price of USD 6.97 per share at any time following the signing of the agreement with respect to 10.5% of Comstar UTS' shares. The call option for the remaining 0.56% stake could be exercised at any time beginning from April 1, 2007. The call option was to expire in one year from the date of signing of the agreement. 2711 UA had a right to exercise its put option at any time within two years from the date of exercising the call option at a strike price, which will be calculated based on a weighted average price of Comstar UTS' GDRs during the 90 trading days period preceding the exercise of the put option.

Fair value of the call and put option as of December 11, 2006, the grant date, was estimated at \$90.0 million and included in cost of investment in Svyazinvest. The Group was estimating the fair value of the respective liability using an option pricing model and was re-measuring it as of each balance sheet date. Respective gains and losses were included in the statement of operations for the period.

On December 7, 2007, Access Telecommunications Cooperatief U.A. ("Access", previously known as 2711 UA) has exercised the call option for 46,232,000 shares and paid \$322.2 million in cash to the Group.

On August 25, 2008, Access has initiated the process of exercising the put option, and on November 26, 2008 has sold MGTS Finance S.A. 46,232,000 shares of Comstar UTS for the total of \$463.6 million, \$100.0 million of which had been paid on November 26, 2008 in cash, and the remaining portion had been restructured in the form of an interest-bearing promissory note repayable in four monthly installments (see Note 16).

The reconciliations of the beginning and closing balances of the liability under the call and put option for the years ended December 31, 2008 and 2007, are as follows:

OJSC COMSTAR UTS AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEARS ENDED DECEMBER 31, 2008 and 2007 (Amounts in thousands of US dollars, unless otherwise stated)

	Year ended December 31,	
	2008	2007
Balance at January 1	\$ 88,000	\$ 150,000
Revaluation charge included in earnings	27,940	145,859
Exercise of the put option in 2008 and the call option in 2007	(116,812)	(223,444)
Currency translation effect (included in other comprehensive income).....	872	15,585
Balance at December 31	\$ —	\$ 88,000

Purchased Call Option

In order to hedge the exposure resulting from the employee phantom option program introduced in April 2008 (see Note 28), in the third quarter of 2008 the Group acquired a phantom call option on the GDRs of Comstar UTS for \$19.4 million from an investment bank. The agreement entitles the Group to receive in the second quarter of 2010 a payment equal to the difference between the average of daily volume-weighted average trading prices of Comstar GDR on the London Stock Exchange for the period between February 1 and March 31, 2010 and the phantom option exercise price of USD 10.2368, if positive, multiplied by 9,000,000. Subsequent to the acquisition of the instrument, the Group estimates the fair value of the respective asset using an option pricing model and re-measures it as of each balance sheet date. Respective gains and losses are included in the statement of operations for the period.

The reconciliation of the beginning and closing balances of the purchased call option balance for the year ended December 31, 2008 is as follows:

Balance at January 1, 2008	\$ —
Acquisition of the instrument	19,422
Revaluation charge included in earnings	(13,614)
Currency translation effect (included in other comprehensive income)....	22
Balance at December 31, 2008	\$ 5,830

The following assumptions were used in the option-pricing model as of December 31, 2008:

Risk-free interest rate.....	3%
Expected residual option life (months).....	15
Expected dividends.....	Notional
Expected volatility	94.5%

Currency Forward

In December 2008, to hedge against foreign currency risks under the USD-denominated notes payable to Access (see Note 16) the Group entered into forward contracts with MBRD to acquire \$32.0 and \$68.0 million of USD in January and February 2009, respectively, at a rate of RUR 27.85 per one USD. The reconciliation of the beginning and closing balance of the forward contract balance for the year ended December 31, 2008 is as follows:

OJSC COMSTAR UTS AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEARS ENDED DECEMBER 31, 2008 and 2007 (Amounts in thousands of US dollars, unless otherwise stated)

Balance at January 1, 2008	\$	–
Cash paid at the inception of the instrument.....		–
Foreign exchange gains included in earnings		10,165
Currency translation effect (included in other comprehensive income).....		<u>(431)</u>
Balance at December 31, 2008	\$	<u>9,734</u>

The Group measures fair value of these forward contracts using inputs other than quoted prices (“Level 2” Inputs of SFAS No. 157 hierarchy), including market value of forward contracts with similar maturities.

19. RETIREMENT AND POST-RETIREMENT OBLIGATIONS

MGTS has historically provided certain benefits to employees upon their retirement and afterwards, which include monthly regular pension, death-in-service payments, lump-sum upon retirement payments, death-while-pensioner payments and 50% monthly telephone subsidy for the pensioners who served more than 30 years at MGTS. As of December 31, 2008, there were 10,853 active employees eligible to the program. The pension plan is terminally funded, i.e., upon retirement MGTS transfers all its obligations to a pension fund (NPF “Sistema”), a subsidiary of Sistema, and from that moment onwards has no more obligations towards the pensioner regarding the pension plan. All other program benefits are financed on a pay-as-you-go basis.

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

Discount rate	9.00% p.a.
Expected return on plan assets.....	10.62% p.a.
Projected salary growth	10.24% p.a.
Discount rate used for annuity contracts calculation	7.00% p.a.
Rate at which pension payment are assumed to be indexed	0.00% p.a.
Long-term inflation.....	6.00% p.a.
Staff turnover (for ages below 50)	10.00% p.a.

OJSC COMSTAR UTS AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEARS ENDED DECEMBER 31, 2008 and 2007 (Amounts in thousands of US dollars, unless otherwise stated)

The change in the projected benefit obligation and the change in plan assets for the years ended December 31, 2008 and 2007 are presented in the following table:

	2008			2007		
	Old age pension	Other benefits	Total	Old age pension	Other benefits	Total
Change in projected benefit obligation						
Projected benefit obligation, beginning of the year.....	\$ 17,381	\$ 20,909	\$ 38,290	\$ 7,236	\$ 8,706	\$ 15,942
Service cost.....	807	794	1,601	706	850	1,556
Interest cost.....	1,102	1,083	2,185	440	530	970
Plan amendments losses/(gains)	66	1,844	1,910	(746)	—	(746)
Actuarial (gains)/losses.....	(2,355)	265	(2,090)	10,404	7,751	18,155
Benefit payment.....	—	(5,701)	(5,701)	—	(1,395)	(1,395)
Settlement and curtailment gain	(2,689)	—	(2,689)	(1,574)	(1,102)	(2,676)
Termination benefits	—	2,102	2,102	—	4,471	4,471
Foreign currency translation effect	(2,388)	(3,499)	(5,887)	915	1,098	2,013
Projected benefit obligation, end of the year	11,924	17,797	29,721	17,381	20,909	38,290
Change in fair value of plan asset						
Fair value of plan assets, beginning of the year	2,473	—	2,473	5,760	—	5,760
Actual return on plan assets.....	187	—	187	103	—	103
Employer contributions	604	5,701	6,305	1,365	1,395	2,760
Benefits paid	—	(5,701)	(5,701)	—	(1,395)	(1,395)
Settlement	(2,689)	—	(2,689)	(1,575)	—	(1,575)
Foreign currency translation effect	(104)	—	(104)	270	—	270
Other	—	—	—	(3,450)	—	(3,450)
Fair value of plan assets, end of the year	471	—	471	2,473	—	2,473
Unfunded status of the plan, end of the year, net.....	\$(11,453)	\$(17,797)	\$(29,250)	\$(14,908)	\$(20,909)	\$(35,817)

The changes in the projected benefit obligation due to actuarial losses for the years ended December 31, 2008 and 2007 relate primarily to the changes in the discount rate and employees turnover assumptions.

OJSC COMSTAR UTS AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEARS ENDED DECEMBER 31, 2008 and 2007 (Amounts in thousands of US dollars, unless otherwise stated)

Reconciliations of the unfunded status of the plan for the years ended December 31, 2008 and 2007 are as follows:

	2008			2007		
	Old age pension	Other benefits	Total	Old age pension	Other benefits	Total
Unfunded status of the plan, beginning of the year.....	\$ 14,908	\$ 20,909	\$ 35,817	\$ 1,476	\$ 8,706	\$ 10,182
Net periodic benefit cost.....	2,570	4,576	7,146	1,043	5,851	6,894
Contributions made.....	(604)	(5,701)	(6,305)	(1,365)	(1,395)	(2,760)
(Credit)/charge to other comprehensive income, net	(3,137)	1,512	(1,625)	9,659	6,649	16,308
Foreign currency translation effect	(2,284)	(3,499)	(5,783)	645	1,098	1,743
Other	—	—	—	3,450	—	3,450
Unfunded status of the plan, end of the year	\$ 11,453	\$ 17,797	\$ 29,250	\$ 14,908	\$ 20,909	\$ 35,817

The components of the net periodic pension expense for the years ended December 31, 2008 and 2007 are as follows:

	2008			2007		
	Old age pension	Other benefits	Total	Old age pension	Other benefits	Total
Service cost.....	\$ 807	\$ 794	\$ 1,601	\$ 706	\$ 850	\$ 1,556
Interest cost.....	1,102	1,083	2,185	440	530	970
Return on assets	(187)	—	(187)	(103)	—	(103)
Termination benefits in connection with established staff reduction program	—	2,102	2,102	—	4,471	4,471
Net actuarial loss recognized in a year ..	933	597	1,530	—	—	—
Amortization of prior service cost	(85)	—	(85)	—	—	—
Net periodic pension expense	\$ 2,570	\$ 4,576	\$ 7,146	\$ 1,043	\$ 5,851	\$ 6,894

Amounts recognized in other comprehensive income for the years ended December 31, 2008 and 2007 are as follows:

	2008			2007		
	Old age pension	Other benefits	Total	Old age pension	Other benefits	Total
Unrecognized losses	\$ (3,289)	\$ (331)	\$ (3,620)	\$ 10,423	\$ 6,649	\$ 17,072
Unrecognized prior service cost/(credit).....	152	1,843	1,995	(764)	—	(764)
Total recognized in other comprehensive income	\$ (3,137)	\$ 1,512	\$ (1,625)	\$ 9,659	\$ 6,649	\$ 16,308

The estimated net loss and prior service credit for the defined benefit pension plans that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the year ending December 31, 2009 are \$1.1 million and \$0.1 million, respectively.

OJSC COMSTAR UTS AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEARS ENDED DECEMBER 31, 2008 and 2007 (Amounts in thousands of US dollars, unless otherwise stated)

The Group's management expects contributions to the plan during the year ended December 31, 2009 to amount to \$3.4 million.

The future benefit payments to retirees under the defined benefit plan are expected to be as follows: 2009 – \$3.4 million; 2010 – \$1.7 million; 2011 – \$2.1 million, 2012 – \$2.2 million, 2013 – \$2.6 and an aggregate of \$22.9 million in 2014 to 2018.

In connection with reorganization and headcount reduction program adopted in 2007, management has estimated an additional liability in respect to lump-sum payments upon retirement in the projected benefit obligation ("PBO"), which resulted in an increase in PBO of approximately \$9.7 million as of December 31, 2007, and revised estimated staff turnover rate, which was increased to 10% per annum. In addition, due to adoption of new motivation scheme at MGTS, estimated future salary growth was increased to 9.2% per annum, which resulted in a difference of approximately \$13.6 million between PBO and accumulated benefit obligation ("ABO") as of December 31, 2007. ABO as of December 31, 2008 and 2007 amounted to \$18.9 million and \$24.7 million, respectively.

NPF "Sistema" does not allocate any separately identifiable assets to its clients such as MGTS. Instead, it operates a pool of investments where it invests the funds from the pension solidarity and individual accounts. The pool of investments includes primarily investments in Russian corporate bonds, Russian governmental bonds and shares of Russian issuers.

20. PROPERTY, PLANT AND EQUIPMENT CONTRIBUTIONS

MGTS receives telecommunication infrastructure which is intended to operate as an integral part of the Moscow city wire line network from the real estate constructors free of charge as provided by the regulations of the city government. Property, plant and equipment contributions received by MGTS during the years ended December 31, 2008 and 2007 were as follows:

	<u>2008</u>	<u>2007</u>
Unamortized property, plant and equipment contributions, beginning of the year	\$ 112,779	\$ 103,793
Contributions received during the year.....	3,194	6,299
Currency translation effect.....	(18,395)	6,815
Amortization for the year.....	<u>(4,381)</u>	<u>(4,128)</u>
Unamortized property, plant and equipment contributions, end of the year	\$ <u>93,197</u>	\$ <u>112,779</u>

OJSC COMSTAR UTS AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEARS ENDED DECEMBER 31, 2008 and 2007 (Amounts in thousands of US dollars, unless otherwise stated)

21. SHAREHOLDERS' EQUITY

Common stock

Comstar UTS' share capital comprises of one class of common shares with each share having equal voting rights. As at December 31, 2008 and 2007, the Group had of 417,940,860 authorized and issued common shares, including respectively 146,242,211 and 145,118,407 shares in form of GDRs, with par value of RUR 1, and amounted to \$23,900.

Exercise of call and put options

As discussed in Note 18, on December 7, 2007, Access has exercised the call option for 46,232,000 shares of Comstar UTS and paid \$322.2 million in cash to the Group.

In November 2008, following the exercise of the put option, MGTS Finance S.A. has re-acquired 46,232,000 shares of Comstar UTS, representing 11.06% of total issued shares from Access (see Note 18).

Treasury stock

All shares of Comstar UTS owned by the Group are accounted for as treasury stock and are recorded at par value in the accompanying consolidated financial statements with the difference between par value and the cost of acquisition accounted for as a reduction to additional paid-in capital in the statement of changes in shareholders' equity.

At December 31, 2008 and 2007, there are 57,742,500 and 11,510,500, respectively, of Comstar UTS shares held by MGTS and its wholly-owned subsidiaries. Market price of one GDR of Comstar UTS on London Stock Exchange as of December 31, 2008 and 2007 was USD 3.95 and USD 12.59, respectively. Total value of these shares, based on market prices, were \$228.1 million and \$144.9 million at December 31, 2008 and 2007, respectively, of which \$101.0 million and \$64.2 million, respectively, relate to minority shareholders of MGTS.

The reconciliation of the beginning and closing balances of the number of shares authorized, issued and outstanding for the years ended December 31, 2008 and 2007 is as follows:

	Total shares authorized and issued	Treasury stock	Total shares authorized, issued and outstanding
As of January 1, 2007	417,940,860	(59,712,504)	358,228,356
Exercise of the call option (see Note 18)	—	46,232,000	46,232,000
Mandatory acquisition of treasury stock from a minority shareholder	—	(3,500)	(3,500)
As of December 31, 2007	417,940,860	(13,484,004)	404,456,856
Exercise of the put option (see Note 18)	—	(46,232,000)	(46,232,000)
As of December 31, 2008	417,940,860	(59,716,004)	358,224,856

OJSC COMSTAR UTS AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEARS ENDED DECEMBER 31, 2008 and 2007 (Amounts in thousands of US dollars, unless otherwise stated)

Distributable earnings

In accordance with Russian legislation, dividends may only be declared to the shareholders of the Company from accumulated undistributed and unreserved earnings as reported in the Company's Russian statutory financial statements, subject to certain restrictions. Comstar UTS had approximately RUR 10,915.4 million (approximately \$371.5 million) of undistributed and unreserved earnings as at December 31, 2008.

MGTS' preferred stock

MGTS, a subsidiary of Comstar UTS, had 15,965,850 preferred shares outstanding at December 31, 2008. MGTS' preferred shares carry guaranteed non-cumulative dividend rights amounting to the higher of (a) 10% of MGTS' net profit as determined under Russian accounting regulations and (b) the dividends paid on common shares. No dividends may be declared on common shares before dividends on preferred shares are declared. If the preferred dividend is not paid in full in any year the preferred shares also obtain voting rights, which will lapse after the first payment of the dividend in full. Otherwise, preferred shares carry no voting rights except on resolutions regarding liquidation or reorganization of MGTS and changes/amendments to MGTS' charter restricting the rights of holders of preferred shares. Such resolutions require the approval of 75% of the preferred shareholders. In the event of liquidation, dividends to preferred shareholders that have been declared but not paid have priority over ordinary shareholders.

22. OPERATING REVENUES

Operating revenues for the years ended December 31, 2008 and 2007 consisted of the following:

	<u>2008</u>	<u>2007</u>
Traditional Segment in Moscow		
Residential subscribers		
Voice.....	\$ 492,205	\$ 516,370
Value-added services	12,288	11,601
Broadband Internet and access and other.....	9,688	3,845
Total residential subscribers	<u>514,181</u>	<u>531,816</u>
Corporate subscribers		
Voice.....	174,272	167,585
Access node/Trunk rental	76,705	67,884
Value-added services	15,531	15,724
Other	17,794	15,584
Total corporate subscribers.....	<u>284,302</u>	<u>266,777</u>
Operators		
Rent of access nodes	145,448	188,537
Rent of data transmission ports.....	76,582	65,145
Initiation and termination of traffic, including DLD/ILD.....	77,057	35,037
Other	38,245	25,174
Total operators	<u>337,332</u>	<u>313,893</u>
Inter-segment revenue	<u>(141,542)</u>	<u>(127,033)</u>
Total revenue of the Traditional Segment in Moscow, net	\$ <u>994,273</u>	\$ <u>985,453</u>

OJSC COMSTAR UTS AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEARS ENDED DECEMBER 31, 2008 and 2007 (Amounts in thousands of US dollars, unless otherwise stated)

	2008	2007
Alternative Segment in Moscow		
Residential subscribers		
Broadband Internet access and pay-TV	\$ 106,968	\$ 104,237
Dial-up Internet access	2,132	4,650
Voice and other	8,931	11,454
Total residential subscribers	118,031	120,341
Corporate subscribers		
Voice	76,491	66,686
Data and Internet	120,837	93,852
Value-added services and other	32,115	29,394
Total corporate subscribers	229,443	189,932
Operators	172,029	142,230
Inter-segment revenue	(31,012)	(3,286)
Total revenue of the Alternative Segment in Moscow, net.....	\$ 488,491	\$ 449,217
Alternative Segment in Regions and the CIS		
Corporate subscribers	\$ 74,678	\$ 21,358
Residential subscribers	51,842	10,058
Operators	38,381	15,436
Total revenue of Alternative Segment in Regions and the CIS, net	\$ 164,901	\$ 46,852
Total revenue of the Group, net	\$ 1,647,665	\$ 1,481,522

Substantially all inter-segment revenue for the years ended December 31, 2008 and 2007 was comprised of revenue from services to operators.

Included in residential voice revenue of the Traditional Segment in Moscow for year ended December 31, 2007 is approximately \$36.6 million of cash received as compensation from the federal budget of the discounts on installation and monthly fees to certain categories of residential subscribers, such as pensioners and military veterans, granted according to the applicable legislation prior to January 1, 2005 (see Note 2).

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEARS ENDED DECEMBER 31, 2008 and 2007 (Amounts in thousands of US dollars, unless otherwise stated)

23. OPERATING EXPENSES, EXCLUDING DEPRECIATION AND AMORTIZATION AND STOCK-BASED COMPENSATION, NET

Operating expenses, excluding depreciation and amortization and stock-based compensation for the years ended December 31, 2008 and 2007 consisted of the following:

	<u>2008</u>	<u>2007</u>
Employee costs, net of stock-based compensation	\$ 349,310	\$ 339,091
Interconnection and line rental	218,118	159,666
Repairs and maintenance	75,002	67,938
Advertising, selling and marketing	58,500	46,914
Taxes other than income taxes	49,004	41,473
Utilities and energy	44,405	37,591
Rent	37,376	31,910
Security services	20,761	20,967
Bank charges	18,095	18,269
Consulting	13,194	16,136
Transportation	14,966	10,827
Cost of equipment sold	11,079	8,842
IT maintenance	8,894	7,760
Insurance	4,903	7,258
Bad debt expense	6,552	5,374
In-kind compensation from the third parties	(10,679)	(10,778)
Other operating expenses, net	45,612	34,436
Total	\$ <u>965,092</u>	\$ <u>843,674</u>

During the years ended December 31, 2008 and 2007 MGTS has received in-kind compensation from the third parties for the cable and other fixed assets damaged in the course of construction works in Moscow in the amount of \$10.7 million and \$10.8 million, respectively, which have been capitalized in the cost of property, plant and equipment at fair value of assets received.

24. INCOME TAXES

The Group's provision for income taxes for the years ended December 31, 2008 and 2007 was as follows:

	<u>Year ended December 31,</u>	
	<u>2008</u>	<u>2007</u>
Current income tax	\$ 96,705	\$ 101,130
Deferred income tax	9,393	9,871
Total	\$ <u>106,098</u>	\$ <u>111,001</u>

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEARS ENDED DECEMBER 31, 2008 and 2007 (Amounts in thousands of US dollars, unless otherwise stated)

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

	Year ended December 31,	
	2008	2007
Income tax charge computed on income before income taxes, income from affiliates and other investees and minority interests at standard rate applicable to the Group of 24%	\$ 99,729	\$ 59,648
Change in valuation allowance	(9,343)	(6,953)
Non-deductible stock-based compensation (the 2006 Program, see Note 28)	(2,198)	2,469
Decrease in deferred tax liability on property subject to registration	—	(10,018)
Change in fair value of derivative financial instruments (Note 15)	9,973	35,006
Impairment of long-term investments and loans (Note 11)	451	5,446
Foreign currency transactions differences, net	7,726	1,884
Effect of change in statutory tax rate from 24% to 20% effective January 1, 2009	(15,719)	—
Non-deductible expenses and other, net	15,479	23,519
Provision for income taxes	\$ 106,098	\$ 111,001

In November 2007, management has taken a decision to register certain property with the state authorities. Such registration will enable the Group to make the depreciation of respective property tax deductible. As a result, the Group has decreased its deferred tax liabilities as of December 31, 2007 and provision for income taxes for the year then ended by \$10.0 million, which resulted in an increase in basic and diluted EPS for the year ended December 31, 2007 by USD 0.03.

Effective January 1, 2009, prevailing tax rate in Russia had been decreased to 20%.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEARS ENDED DECEMBER 31, 2008 and 2007 (Amounts in thousands of US dollars, unless otherwise stated)

Temporary differences between the tax and accounting bases of assets and liabilities give rise to the following deferred tax assets and liabilities at December 31, 2008 and 2007:

	<u>2008</u>	<u>2007</u>
Deferred tax assets		
Deferred connection fees	\$ 25,581	\$ 36,881
Property, plant and equipment contributions	18,491	27,067
Valuation of property, plant and equipment	13,971	26,183
Accrued operating expenses	8,778	13,290
Other	6,063	12,580
Less: valuation allowance	(13,971)	(26,183)
Total	<u>58,913</u>	<u>89,818</u>
Deferred tax liabilities		
Property, plant and equipment, net	\$ (90,763)	\$ (136,638)
Intangible assets, net	(47,980)	(34,305)
Other	(9,389)	(1,457)
Total	<u>\$ (148,132)</u>	<u>\$ (172,400)</u>
Deferred tax position, net	<u>\$ (89,219)</u>	<u>\$ (82,582)</u>
Including:		
Deferred tax assets, current portion	11,142	29,910
Deferred tax assets, non-current portion (see Note 14)	841	1,631
Deferred tax liabilities, long-term portion	(101,202)	(114,123)

A reconciliation of the beginning and ending amounts of unrecognized income tax benefits, excluding interest and penalties, for the years ended December 31, 2008 and 2007 is as follows:

	<u>Year ended December 31,</u>	
	<u>2008</u>	<u>2007</u>
Balance at January 1	\$ 3,425	\$ 3,434
Additions based on tax positions related to the current year	726	1,369
Additions of tax positions of prior years	—	—
Reductions of tax positions of prior years	(1,035)	(1,618)
Currency translation effect	(516)	240
Balance at December 31	<u>\$ 2,600</u>	<u>\$ 3,425</u>

Management considers it reasonably possible that approximately \$1.0 million of the unrecognized income tax benefit will be reversed within the next twelve months due to expiration of the statute of limitations. The entire amount of unrecognized tax benefits, if recognized, would affect the effective tax rate.

Accrued penalties and interest related to unrecognized tax benefits as a component of income tax expense for the years ended December 31, 2008 and 2007 amounted to \$0.2 million and \$0.5 million, respectively, and are included in income tax expense in the accompanying consolidated statements of operations. Accrued interest and penalties were included in trade accounts payable, accrued expenses and other current liabilities in the accompanying consolidated balance sheets and totalled \$1.2 million and \$1.3 million as of December 31, 2008 and 2007, respectively.

OJSC COMSTAR UTS AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEARS ENDED DECEMBER 31, 2008 and 2007 (Amounts in thousands of US dollars, unless otherwise stated)

25. SEGMENT INFORMATION

The Group operates in three business segments – Traditional segment in Moscow (comprised of MGTS and subsidiaries), Alternative segment in Moscow (comprised of Comstar UTS, excluding regional branches, and all subsidiaries operating in Moscow and the Moscow region except MGTS and its subsidiaries) and Alternative segment in the regions and the CIS (comprised of all entities of the Group operating outside Moscow and the Moscow Region). The Group has presented its business segments consistent with the information used by the chief operating decision maker to manage the operations for purposes of making operating decisions and allocating resources. The Group's management evaluates performance of the segments based on operating revenues and operating income before depreciation and amortization ("OIBDA"). All transactions between reportable segments are accounted for based on respective contractual provisions between the respective entities.

An analysis and reconciliation of the Group's business segment information to the respective information in the financial statements and as of December 31, 2008 and 2007 and for the years then ended is as follows:

	As of and for the year ended December 31, 2008				
	Traditional segment in Moscow	Alternative segment in Moscow	Alternative segment in the regions and the CIS	Elimina- tions and other	Total
Operating revenues.. \$	1,135,815	\$ 519,503	\$ 164,901	\$ (172,554)	\$ 1,647,665
Depreciation and amortization	116,116	48,217	32,675	(1,337)	195,671
Operating income.....	397,778	75,188	23,680	(2,801)	493,845
OIBDA.....	513,894	123,405	56,355	(4,138)	689,516
Interest income.....	17,389	32,156	4,871	(16,320)	38,096
Interest expense	4,798	77,242	6,260	(16,321)	71,979
Income tax expense..	94,829	11,498	7	(236)	106,098
Change in fair value of derivative financial instruments.....	27,940	13,614	–	–	41,554
Impairment of long- term investments and loans	42	1,836	–	–	1,878
Segment assets	2,202,876	1,860,745	442,974	(370,489)	4,136,106
Cash and cash equivalents	8,559	19,979	4,172	–	32,710
Indebtedness ^(a)	443,473	921,295	113,213	(262,809)	1,215,172
Capital expenditures ^(b)	231,368	72,509	50,098	–	353,975

OJSC COMSTAR UTS AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEARS ENDED DECEMBER 31, 2008 and 2007 (Amounts in thousands of US dollars, unless otherwise stated)

	As of and for the year ended December 31, 2007				
	Tradition- al seg- ment in Moscow	Alternati- ve seg- ment in Moscow	Alternative segment in the regions and the CIS	Elimina- tions and other	Total
Operating revenues	\$ 1,112,486	\$ 452,503	\$ 46,852	\$ (130,319)	\$ 1,481,522
Depreciation and amortization	109,281	49,634	12,457	(620)	170,752
Operating income.....	438,639	29,743	(7,943)	(3,630)	456,809
OIBDA.....	547,920	79,377	4,514	(4,250)	627,561
Interest income.....	8,584	36,674	224	(30,430)	15,052
Interest expense	25,654	55,640	2,576	(30,430)	53,440
Income tax expense.....	100,889	8,578	696	838	111,001
Change in fair value of derivative financial instruments.....	145,859	—	—	—	145,859
Impairment of long- term investments and loans	5,860	16,831	—	—	22,691
Segment assets	2,519,211	2,007,348	319,671	(215,893)	4,630,337
Cash and cash equivalents	93,624	72,799	13,371	—	179,794
Indebtedness ^(a)	227,781	879,935	29,092	(125,501)	1,011,307
Capital expenditures ^(b) ..	246,191	86,110	13,128	—	345,429

^(a) – Represents the total of short-term and long-term debt and capital lease obligations.

^(b) – Determined as cash paid for acquisition of PP&E and intangible assets.

The majority of the corporate costs are born by the Alternative segment in Moscow.

The reconciliation of segment OIBDA to the income before income tax, income from affiliates and other investees and minority interests for the years ended December 31, 2007 is as follows:

	Year ended December 31,	
	2008	2007
Total segment OIBDA	\$ 693,654	\$ 631,811
Inter-segment eliminations	(4,138)	(4,250)
OIBDA	689,516	627,561
Depreciation and amortization.....	(195,671)	(170,752)
Operating income.....	493,845	456,809
Interest income.....	38,096	15,052
Interest expense	(71,979)	(53,440)
Change in fair value of derivative financial instruments	(41,554)	(145,859)
Impairment of long-term investments and loans	(1,878)	(22,691)
Foreign currency transactions loss, net.....	(998)	(4,555)
Gain from disposal of an affiliate	—	3,216
Income before income tax, income from affiliates and other investees and minority interests.....	\$ 415,532	\$ 248,532

For the years ended December 31, 2008 and 2007 the Group did not have revenues from transactions with a single external customer amounting to 10% or more of the Group's revenues.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEARS ENDED DECEMBER 31, 2008 and 2007 (Amounts in thousands of US dollars, unless otherwise stated)

26. RELATED PARTY TRANSACTIONS

Related parties include entities under common ownership and control with the Group, members of key management personnel and affiliated companies, and Svyazinvest, in which the Group owns 25% plus one share stake (see Note 12) and which owns approximately 28% voting shares in MGTS. The Group enters into various trading transactions, such as sales and purchases of interconnection, rental and other services, and miscellaneous investing and financing transactions with related parties. The amounts recognized are not necessarily indicative of the amounts that would be recognized for transactions with third parties.

Trading Transactions

For the years ended December 31, 2008 and 2007, trading transactions with related parties are as follows:

	Year ended December 31,	
	2008	2007
Sales to related parties:		
MTS, a subsidiary of Sistema (including fee for utilization of the Group's numbering capacity by MTS' subscribers, rental of buildings and premises housing the equipment, interconnection and other).....	\$ 70,384	\$ 62,553
Sky Link and subsidiaries, an affiliate of Sistema (interconnection and other).....	7,977	9,857
Svyazinvest and subsidiaries (interconnection, commission for provision of DLD/ILD services to the Group's subscribers and other).....	63,147	69,094
Mezhregion Tranzit Telecom, an affiliate of Sistema (commission for provision of DLD/ILD services to the Group's subscribers, interconnection and other)	37,530	30,763
Other related parties (telecommunication and other services).....	8,520	6,022
Total sales to related parties	\$ 187,558	\$ 178,289
Operating expenses incurred on transactions with related parties:		
MTS (interconnection and other)	\$ 51,238	\$ 38,190
Svyazinvest and subsidiaries (interconnection and other)	41,533	36,633
Mezhregion Tranzit Telecom (interconnection and other)	12,670	35,546
RA Maxima, a subsidiary of Sistema (advertising)	2,958	7,129
Sitronics, a subsidiary of Sistema (IT consulting)	8,961	7,816
Other related parties	7,640	3,258
Total operating expenses incurred on transactions with related parties	\$ 125,000	\$ 128,572

In addition to above, in 2007 Comstar-Direct has sold substantially all TV content and certain PP&E to SMM for \$14.8 million (exclusive of VAT). Respective gains totalling \$2.7 million were included in accompanying consolidated statement of operations. In December 2008, respective receivables were transferred to SMM in the course of reorganization of Comstar-Direct (see Note 3).

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEARS ENDED DECEMBER 31, 2008 and 2007 (Amounts in thousands of US dollars, unless otherwise stated)

As of December 31, 2008 and 2007 accounts receivable from and accounts payable to related parties were as follows:

	December 31,	
	2008	2007
Trade accounts receivable from related parties:		
MTS	\$ 7,035	\$ 9,921
Sky Link and subsidiaries	4,319	3,912
Svyazinvest and subsidiaries	9,334	15,966
Mezhregion Tranzit Telecom	2,659	2,792
SMM	14,416	267
Other related parties	2,217	2,419
Total trade accounts receivable from related parties	\$ 39,980	\$ 35,277
Other receivables from related parties		
Receivables from SMM for TV content and PP&E	\$ –	\$ 17,504
Other	1,362	4,135
Total other receivables from related parties	\$ 1,362	\$ 21,639
Trade accounts payable to related parties:		
MTS	\$ 13,602	\$ 5,948
Svyazinvest and subsidiaries	6,387	7,461
Mezhregion Tranzit Telecom	10,005	7,981
Sistema Mass Media	7,675	–
Other related parties	4,664	5,864
Total trade accounts payable to related parties	\$ 42,333	\$ 27,254

In addition to above, in 2008 and 2007, the Group received dividends from Svyazinvest totaling \$2.4 million and \$1.9 million, respectively.

Investing Transactions

For the years ended December 31, 2008 and 2007, investing transactions with related parties are as follows.

Sitronics

The Group purchases telecommunication and other equipment and software from Sitronics, a subsidiary of Sistema. The cost of equipment and software purchased from Sitronics during the years ended December 31, 2008 and 2007 was \$78.1 million and \$62.9 million, respectively. Related accounts payable as of December 31, 2008 and 2007 amounted to \$27.3 million and \$16.3 million, respectively. As of December 31, 2008 and 2007, advances related to acquisition of equipment and software from Sitronics amounted to \$1.6 million and \$16.9 million, respectively.

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Sistema Hals

As described in Note 27, MGTS entered into a series of agreements with Sistema Hals, a subsidiary of Sistema, on project development and reconstruction of buildings which house MGTS' automatic telephone exchanges. As of December 31, 2008 and 2007, as a result of the work performed by Sistema Hals under these contracts, MGTS recorded a liability of \$36.8 million and \$30.8 million, respectively, payable to Sistema Hals (see also Notes 27 and 30). Respective input VAT was included in other long-term investments and loans in the accompanying consolidated balance sheets (see Note 13).

In 2007, the Group provided Sistema Hals a loan (see Note 5). In addition, Sistema Hals guaranteed a loan provided by the Group to Remstroytrest, a variable interest entity whose primary beneficiary was Sistema Hals (see Note 5). The loan to Remstroytrest was fully repaid in 2008.

In addition, the Group has made certain investments in and loans to related parties. Respective balances and income statement amounts are summarized as follows:

	Year ended December 31,	
	2008	2007
Investments in shares as of December 31 (Note 13):		
MBRD, a subsidiary of Sistema.....	\$ 5,402	\$ 6,466
SMM, a subsidiary of Sistema	3,970	4,751
TS-Retail, a subsidiary of Sistema	—	2,105
Coral-Sistema Strategic Fund, an affiliate of Sistema	2,966	860
Other	1,431	1,127
Total investments in shares of related parties	\$ 13,769	\$ 15,309
Loans to and promissory notes of related parties as of December 31 (Note 5 and 13; excluding cash equivalents disclosed in Note 4):		
Sistema Telecom, a subsidiary of Sistema.....	\$ 51,966	58,319
Alt, an affiliate of Sistema	85,091	—
Delfa, an affiliate of Sistema.....	68,073	—
Finexcort, an affiliate of Sistema	68,073	—
Sky Link and subsidiaries, related parties.....	9,394	12,741
Intellect Telecom, a subsidiary of Sistema	6,315	6,355
Stream TV and subsidiaries	65,455	—
Sistema Hals, a subsidiary of Sistema.....	16,688	19,975
Remstroytrest, a subsidiary of Sistema Hals.....	—	37,196
MBRD, a subsidiary of Sistema.....	—	209,648
Total loans to and promissory notes of related parties ..	\$ 371,055	\$ 344,234

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	Year ended December 31,	
	2008	2007
Interest income earned on investments in and loans to related parties:		
Sistema Telecom, a subsidiary of Sistema.....	\$ 24	\$ 1,893
Alt, Delfa and Finexkort.....	3,536	–
Sky Link and subsidiaries, related parties.....	2,781	973
Intellect Telecom, a subsidiary of Sistema	439	168
Stream TV and subsidiaries	168	–
SMM	352	–
Sistema Hals.....	2,203	151
Remstroytrest	2,319	375
MBRD (including interest earned on cash balances with MBRD – see Note 4).....	22,058	3,887
Total interest income earned on investments in and loans to related parties.....	\$ 33,880	\$ 7,447
Impairment of investments in and loans to related parties (TS-Retail in 2008 and Sky Link in 2007)	\$ 1,878	\$ 21,814

Financing Transactions

InvestSvyazHolding

The Group entered into agreements with InvestSvyazHolding, a subsidiary of Sistema, for leasing of network equipment and billing systems, which have been recorded as capital leases as required by SFAS No. 13, “Accounting for Leases” (see Note 17).

MBRD

In 2006, the Group entered into a loan agreement with MBRD (see Note 16). Interest expense on this loan for the years ended December 31, 2008 and 2007 was immaterial.

Svyazinvest

In 2008 and 2007, the Group paid dividends to Svyazinvest of \$3.6 million and \$7.6 million, respectively.

27. COMMITMENTS AND CONTINGENCIES

Capital Commitments

In December 2003, MGTS announced its long-term investment program for the period from 2004 to 2012, providing for extensive capital expenditures, including expansion and full digitalization of the Moscow telephone network. The program was approved by the resolution of the Moscow City Government on December 16, 2003. At the inception of the investment program, capital expenditures were estimated to be approximately \$1,600.0 million and included reconstruction of 350 local telephone stations and installation of 4.3 million of new phone lines. As a result of implementation of the investment program, new digital equipment will be installed in the buildings housing the telephone nodes, and a substantial amount of floor space will become available after the replacement of analogue switching equipment. The additional free floor space after reconstruction is expected to be sold to third

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEARS ENDED DECEMBER 31, 2008 and 2007 (Amounts in thousands of US dollars, unless otherwise stated)

parties or rented out. There are 113 automatic telephone station buildings which are to be reconstructed or rebuilt in the course of the investment program. Currently, the management had not made a decision whether to sell the free floor space created in the course of the investment program or to rent it out.

In November 2006, MGTS signed an agreement with the Moscow City Government, under which MGTS' investment program was approved. Under the agreement, the Moscow City Government is entitled to receive not less than 30% of the market value of additional floor space constructed during the course of the investment program. The obligation arises at the time the reconstruction of specified properties is completed. In December 2003, MGTS made a prepayment to Moscow City Government under this program which will be offset against the future liability arising as a result of the investment program (see Note 13).

In the course of implementation of the investment program, MGTS entered into a series of agreements with Sistema Hals, a subsidiary of Sistema, related to project development and reconstruction of buildings housing the telephone stations. The main portion of the work under these contracts was to be performed between 2006 and 2012. Under the agreements, Sistema Hals was to prepare the project documentation and perform construction works on behalf of MGTS, and MGTS was to reimburse all the expenses incurred in relation to the construction process with a margin of 4.75% on such expenses and will pay a fixed fee of \$0.04 million per one building. During 2008 and 2007, project development and site preparation works were performed by Sistema Hals on 98 sites, which resulted in \$11.0 million and \$17.6 million addition to construction in-progress in 2008 and 2007, respectively, and recognition of payable to Sistema Hals (see Note 26). No construction or other works were performed in relation to the other sites in 2008, as the business plans are still under development (see also Note 30).

Licenses

Substantially all of the Group's revenues are derived from operations conducted pursuant to licenses granted by the Russian Government. Most of these licenses expire in various years ranging from 2009 to 2017. The management has no reason to believe that the licenses will not be renewed or that any license will be suspended or terminated.

Issued Guarantees

In 2006, MGTS became a guarantor under a credit facility provided to InvestSvyazHolding, a subsidiary of Sistema, by Komerční banka, a.s., Prague. The credit line for the total amount of Euro 10.4 million matures in April 2011. MGTS' guarantee amounted to \$12.2 million as of December 31, 2008.

In 2006, MGTS became a guarantor under a credit facility provided to MBRD, a subsidiary of Sistema, by Bankgesellschaft Berlin AG, Berlin. The credit line for the total amount of Euro 2.1 million matures in June 2011. MGTS' guarantee amounted to \$1.5 million as of December 31, 2008.

In 2008, Comstar UTS became a guarantor under two credit facilities provided to Stream TV, a subsidiary of Sistema, by ING Bank (see also Note 13). The facilities for the amount of RUR 292.2 million (approximately \$9.9 million as of December 31, 2008) and \$2.5 million mature in 2014. Comstar UTS' guarantee amounted to \$12.4 million as of December 31, 2008.

Under these guarantees the Group could be potentially liable for a maximum amount of \$26.1 million in case of borrowers' default under the obligations. As of December 31, 2008, no event of default has occurred under any of the guarantees issued by the Group. The Group does not recognize a liability at inception for the fair value of the guarantor's obligation, as provisions of FIN No. 45 do not apply to the guarantees issued between corporations under common control.

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Interest of the Moscow City Government in the Telecommunications Sector in the Moscow Metropolitan Area

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

Taxation Environment

Russia currently has a number of laws related to various taxes imposed by both federal and regional governmental authorities. Applicable taxes include value added tax ("VAT"), corporate income tax and payroll (social) taxes, together with others. Laws related to these taxes have not been in force for significant periods, in contrast to more developed market economies; therefore, the government's implementation of these regulations is often inconsistent or nonexistent. Accordingly, few precedents with regard to tax rulings have been established. Tax declarations, together with other legal compliance areas (for example, customs and currency control matters), are subject to review and investigation by a number of authorities, which are enabled by law to impose extremely severe fines, penalties and interest charges. These facts create tax risks in Russia that are more significant than typically found in countries with more developed tax systems.

Generally, tax declarations remain open and subject to tax audits for a period of three years following the tax year. Tax declarations of Comstar UTS and DTN for 2006, of MGTS and Comstar-Direct for 2006 and 2007, were examined by the tax audit; tax declarations of Comstar UTS for 2007 and 2008 and of the other Group companies for 2006–2008 remain open for the audits. As of the date of these financial statements, tax declarations of Comstar UTS for 2007 are being examined by the tax audit.

Management believes that the Company is in compliance with the tax laws affecting its operations; however, the risk remains that governmental authorities could take differing positions with regard to interpretative issues.

Legal Disputes

In May 2007, certain minority shareholder won the case against MGTS in respect of non-payment of dividend on preferred shares for 2005 (see Note 21) in the court of first instance, which determined such decision of MGTS' general shareholders' meeting in respect of dividends for 2005 null and void. Such dividend, if declared and paid, may amount to RUR 879.0 million (approximately \$29.9 million as of December 31, 2008). In February 2008, appeals to the court of the third instance ruled in favor of MGTS. Management believes that the likelihood of ruling against MGTS in case of appeal by the minority shareholders to the Supreme Arbitration Court is remote.

In December 2008, certain minority shareholders of MGTS filed a case to claim null and void certain decisions of MGTS' Board of Directors, which, they believe, represent a series of interrelated transactions and should have been approved by MGTS' general shareholder meeting. Management believes that the claim is insubstantial.

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

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28. STOCK-BASED COMPENSATION

The 2006 Program

On September 15, 2006, the Extraordinary General Meeting of shareholders approved the stock option and stock bonus program ("the 2006 Program") for the Board of Directors and senior management of Comstar UTS. The 2006 Program was being implemented based on separate decisions of the Board of Directors. In November 2006, the Company's Board of Directors approved the grant of stock options to certain members of the Board of Directors and senior management of Comstar UTS. The exercise price for these options is RUR 122.3 per one GDR (approximately USD 4.6 as of the grant date). These stock options were to cliff-vest in two years from the date of the grant and were exercisable over a period of 1 month after vesting. The 2006 Program provided for the ability of Comstar UTS to repurchase the GDRs issued under the 2006 Program from the participants, subject to separate decision of the Board of Directors. Management believed that possibility of such repurchase was remote; accordingly, the 2006 Program originally was classified as equity.

The following assumptions were used in the option-pricing model:

Risk-free interest rate.....	4.82%
Expected option life (years).....	2
Expected dividend yield	Nil
Expected volatility	38.1%
Grant date fair value of options (per share).....	USD 3.16

Expected volatilities were based on historical volatility of the Company's GDRs.

The following table summarizes information about non-vested common stock options during the year ended December 31, 2007:

	<u>Quantity</u>	<u>Exercise price, RUR</u>	<u>Weighted average grant-date fair value, USD</u>
Non-vested options as of January 1, 2007	3,343,525	122.3	3.16
Options granted.....	—	—	—
Options vested	—	—	—
Options forfeited.....	(940,366)	122.3	3.16
Non-vested options as of December 31, 2007.....	<u>2,403,159</u>	<u>122.3</u>	<u>3.16</u>

During the year ended December 31, 2007, certain options have been forfeited, as employment of certain members of management and the Board of Directors has been terminated. Accordingly, \$0.1 million of costs under the cancelled options recorded during the year ended December 31, 2006 has been reversed in the accompanying consolidated statement of operations for the year ended December 31, 2007.

In March 2008, the Board of Directors of Comstar UTS has approved the repurchase of the GDRs purchased by the participants at the exercise of the options back to the Group at a price equal to an average price of one GDR for the 60 calendar days preceding the date of exercise weighted by trading volumes of Comstar UTS GDRs on the London Stock Exchange. Accordingly, as of December 31, 2007 the Group changed its estimate and re-classified the option program as liability (see Note 15),

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which resulted in a decrease in net income and basic and diluted earnings per share for the year ended December 31, 2007 by \$6.2 million, USD 0.02 and USD 0.02, respectively. The following assumptions were used in the option-pricing model as of December 31, 2007:

Risk-free interest rate.....	3.34%
Expected residual option life (months).....	11
Expected dividends.....	notional
Expected volatility	37.7%
Fair value of options (per share) as of December 31, 2007	USD 7.76

Expected volatilities were based on historical volatility of the Company's GDRs.

In June 2008, General shareholder meeting of Comstar UTS has taken the decision to denominate the exercise price in USD at USD 4.60 per share. The change did not have a significant impact on compensation expense recognized by the Group,

In November 2008, the participants of the 2006 Program fully exercised their vested options, acquired 2,403,159 GDRs from the Group for USD 4.60 per one GDR. The GDRs were then repurchased by the Group at USD 5.34 per one GDR, and the 2006 Program was closed. Total intrinsic value of the exercised options, taking into account the repurchase feature, amounted to \$1.8 million.

The following table summarizes information about non-vested common stock options during the year ended December 31, 2008:

	<u>Quantity</u>	<u>Exercise price, USD</u>	<u>Weighted average grant-date fair value, USD</u>
Non-vested options as of January 1, 2008	2,403,159	N/A	3.16
Options granted.....	—	—	—
Options vested	(2,403,159)	4.60	3.16
Options forfeited.....	—	—	—
Non-vested options as of December 31, 2008.....	—	—	—

The costs recognized in accordance with the 2006 Program for the years ended December 31, 2008 and 2007 approximated (\$9.2) million (a reversal) and \$10.3 million, respectively.

Phantom Option Program

In March 2008, the Board of Directors of Comstar UTS approved the employee phantom option program. Each phantom option is subject to the successful attainment of multiple market and performance conditions, such as shareholder return, market position and revenue growth. The compensation expense for these awards may be adjusted for subsequent changes in the Group's estimated or actual outcome of the performance conditions. The phantom options granted during 2008 vest on March 31, 2010. Upon vesting, the participants will be entitled to a cash compensation equal to the difference between weighted average price of one GDR for the 60 calendar days preceding March 31, 2010 and April 1, 2008, respectively, if positive, timed by the number of phantom options granted.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued) FOR THE YEARS ENDED DECEMBER 31, 2008 and 2007 (Amounts in thousands of US dollars, unless otherwise stated)

The following table summarizes information about phantom options during the year ended December 31, 2008:

	<u>Quantity</u>	<u>Exercise price, USD</u>	<u>Weighted average grant-date fair value, USD</u>
Outstanding as of January 1, 2008.....	—	—	—
Granted	13,065,882	10.2368	2.36
Forfeited.....	(940,000)	10.2368	2.37
Outstanding as of December 31, 2008			
(all non-vested).....	<u>12,125,882</u>	<u>10.2368</u>	<u>2.36</u>

The Group estimates the fair value of the phantom options using stock option pricing model based on Monte-Carlo simulation technique. The following assumptions were used in the option-pricing model as of December 31, 2008:

Risk-free interest rate.....	2.4%
Expected residual option life (months).....	15
Expected dividends.....	Notional
Expected volatility	82%
Fair value of options (per share) as of December 31, 2008	USD 0.36

Expected volatility was based on historical volatility of the Company's GDRs in the fourth quarter of 2008. The costs recognized in accordance with phantom option plan for the year ended December 31, 2008 amounted to \$2.3 million. Total expected future compensation cost related to non-vested awards not yet recognized as of December 31, 2008 amounted to \$10.4 million, which will be recognized on a straight-line basis over 15 months ending March 31, 2010.

29. EARNINGS PER SHARE

The following table reconciles numerator (income) and denominator (shares) of the EPS calculation for the year ended December 31, 2008:

	<u>Income ('000 USD)</u>	<u>Shares (units)</u>	<u>EPS (USD)</u>
EPS – basic	\$ 179,645	399,909,446 \$	0.45
Effect of employee stock option plan (the 2006 Program, see Note 28)	—	383,851	(0.00)
Effect of call and put option (Note 18)	—	11,507,019	(0.04)
EPS – diluted	\$ 179,645	411,800,316 \$	0.41

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The following table reconciles numerator (income) and denominator (shares) of the EPS calculation for the year ended December 31, 2007:

	Income (‘000 USD)	Shares (units)	EPS (USD)
EPS – basic	\$ 43,813	361,394,049	\$ 0.12
Effect of call and put option (Note 18)	–	12,094,838	(0.00)
EPS – diluted	\$ 43,813	373,488,887	\$ 0.12

Employee stock options (see Note 28) were outstanding during the year ended December 31, 2007 but were not included in the computation of diluted EPS because the effect of these options is anti-dilutive.

30. SUBSEQUENT EVENTS

MGTS Investment Program

In February 2009, the Board of Directors of MGTS approved the cancellation of agreements with Sistema Hals (see Note 27) with respect to 26 sites, which also extinguishes the respective portion of MGTS’ liability to Sistema Hals, and signing of 26 new agreements with investor companies (the “New Agreements”). Under the New Agreements, the investor companies would perform all necessary reconstruction work and obtain the property rights for the reconstructed buildings except for the premises locating the digitalized nodes which would remain MGTS property. In addition, within 12 months after transfer of the building into the investment project, MGTS is to receive cash payment equal to MGTS’ share in the value of the building before reconstruction as appraised by an independent valuation firm in 2008, plus interest at 20% per annum accrued for the period from transfer of the building into the project and the date of payment. Currently, management is evaluating the appropriate accounting treatment of the New Agreements. As of the date of these financial statements, the agreements have not been signed by Sistema Hals.

Acquisition of Stream TV

As discussed in Note 13, in December 2008, the Group entered into an agreement with SMM to acquire all of SMM’s interest in Stream TV for a total cash consideration of RUR 3,544.5 million (approximately \$120.6 million as of December 31, 2008), determined by an independent appraiser, payable in installments between December 2008 and March 2009. As of December 31, 2008, transfer of legal title and all risk and rewards of ownership had not yet been finalized.

In the first quarter of 2009, legal title to the business and full control of Stream TV transferred to the Group. As the Group and SMM are under common control, the transaction the assets and liabilities acquired will be recorded at the historical carrying value at the time of acquisition and the historical results will be retroactively restated to reflect the Group as if Stream TV had been owned since the beginning of the earliest period presented.

Depreciation of the Ruble against the USD and Euro

As of April 24, 2009, the official rates of exchange, as determined by the CBR, were 33.78 RUR to 1 US dollar and 44.02 RUR to 1 Euro, which caused certain foreign exchange losses due to revaluation of liabilities denominated in USD and Euro. These losses will be reported in the financial statements for the year ended December 31, 2009.