OAO “Southern Telecommunications Company”

Consolidated Financial Statements as of December 31, 2002

with Independent Auditors’ Report

Contents

INDEPENDENT AUDITORS’ REPORT

To the Shareholders and Board of Directors of OAO “Southern Telecommunications Company”

1. We have audited the accompanying consolidated balance sheet of OAO “Southern Telecommunications Company” (a Russian open joint-stock company - hereinafter “the Company”), as of December 31, 2002, and the related statements of operations, cash flows and shareholders’ equity for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

2. Except as discussed in paragraph 4, we conducted our audit in accordance with International Standards on Auditing issued by the International Federation of Accountants. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

3. As described in note 23 “Pension Plans and Employee Benefits”, the Company has not determined and presented its obligations existing under defined benefits plans in accordance with International Accounting Standard (“IAS”) 19, “Employee Benefits”. We were not able to quantify the adjustments, if any, to the financial statements.

4. As described in note 8 “Property, Plant and Equipment”, the Company’s accounting records relating to fixed assets are not designed to support their presentation in accordance with IAS 16, “Property, Plant and Equipment”, IAS 29, “Financial Reporting in Hyperinflationary Economies” and IAS 36, “Impairment of Assets”. As such, certain estimates were made by management to present fixed assets in the accompanying financial statements. Owing to the nature of the Company’s records, we were unable to satisfy ourselves as to the adjustments, if any, which might have been determined to be necessary had additional evidence been available to better analyze the assumptions and estimates made by management.

5. As a result of the matters described in paragraphs 3 and 4 above, adjustments, if any, could materially affect (i) property, plant and equipment, equipment contributions, assets and liabilities existing under benefit plans, deferred income tax liability, and retained earnings as of December 31, 2002, (ii) depreciation expense, other benefits expense, income tax expense and net income for the year ended December 31, 2002, and (iii) related disclosures.

6. In our opinion, except for the effects on the consolidated financial statements of such adjustments, if any, from the matters referred to in paragraphs 3 and 4 above, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of OAO “Southern Telecommunications Company” as of December 31, 2002, and the results of its operations and its cash flows for the year then ended in conformity with International Financial Reporting Standards.

7. As described in note 1 “Corporate Information”, the Company was the subject of a reorganization that was approved by the shareholders on December 21, 2001. The Company has accounted for the merger based on the principles of uniting of interests as described in IAS 22, “Business Combinations”. In applying this method, the Company has reflected amounts in the consolidated financial statements as if the entities had been combined from January 1, 2002, the earliest period presented.

July 31, 2003

Consolidated Balance Sheet
as of December 31, 2002

(In thousands of rubles in terms of purchasing power of the Ruble at December 31, 2002)

	Notes	December 31, 2002
ASSETS		
NON-CURRENT ASSETS		
Property, plant and equipment, net	**8**	**16 496 257**
Intangible assets, net	**9**	**6 638**
Investments in associates	**11**	**323 964**
Available-for-sale financial assets and other long-term assets	**12**	**186 452**
Advances to suppliers of equipment		**167 414**
Total non-current assets		**17 180 725**
CURRENT ASSETS		
Inventories, net	**14**	**658 333**
Trade accounts receivable, net	**15**	**853 279**
Other current assets	**16**	**481 985**
Investments held for sale	**27**	**187 520**
Cash and cash equivalents	**17**	**229 811**
Total current assets		**2 410 928**
TOTAL ASSETS		**19 591 653**
SHAREHOLDERS' EQUITY AND LIABILITIES		
SHAREHOLDERS' EQUITY		
Preference shares	**18**	**320 810**
Ordinary shares	**18**	**976 969**
Inflation impact on share capital		**1 741 475**
Retained earnings and other reserves		**9 365 143**
Total shareholders' equity		**12 404 397**
COMMITMENTS AND CONTINGENCIES	**24**	**-**
MINORITY INTEREST		**148 539**
NON-CURRENT LIABILITIES		
Long-term borrowings	**19**	**938 749**
Deferred income tax liability	**5**	**684 637**
Obligaions under financial leases	**20**	**225 659**
Equipment contributions		**340 031**
Total non-current liabilities		**2 189 076**

CURRENT LIABILITIES		
Accounts payable and accrued expenses	**21**	**1 342 258**
Taxes and social security payable	**21**	**504 173**
Amount payable to Rostelecom for interconnect fees	**25**	**134 698**
Dividends payable		**204 853**
Current portion of long-term borrowings	**19**	**1 626 756**
Short-term borrowings	**19**	**886 134**
Short-term portion of obligaions under financial leases	**20**	**112 901**
Provisions	**22**	**37 868**
Total current liabilities		**4 849 641**
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		**19 591 653**

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

V.L. Gorbachev
General Director

S.G. Fefilova
Chief Accountant

Consolidated Statement of Operations
for the year ended December 31, 2002

(In thousands of rubles in terms of purchasing power of the Ruble at December 31, 2002)

	Notes	2002
Revenues	**4**	**11 885 370**
Operating expenses		
Wages, salaries, other benefits expenses and payroll taxes		**(4 190 506)**
Interconnection charges		**(1 577 423)**
Materials, repairs and maintenance, utilities		**(1 251 051)**
Taxes other than on income		**(362 340)**
Depreciation and amortization	**8**	**(2 457 100)**
Loss on disposal of property, plant and equipment		**(74 199)**
Bad debt expense		**(123 179)**
Other operating expenses	**4**	**(957 606)**
Total operating expenses		**(10 993 404)**
INCOME FROM OPERATIONS		**891 966**
Income from associates		**271 507**
Interest expenses and similar items, net		**(335 503)**
Gain from sale of investments, net	**11**	**1 097 069**
Other (expenses) income, net		**(156 570)**
Foreign exchange loss, net		**(321 278)**
Net monetary gain		**470 666**
INCOME BEFORE TAXATION AND MINORITY INTEREST		**1 917 857**
INCOME TAX EXPENSE	**5**	**(777 432)**
NET INCOME FROM BEFORE MINORITY INTEREST		**1 140 425**
MINORITY INTEREST		**(94 309)**
NET INCOME		**1 046 116**
PREFERRED DIVIDENDS	**7**	**(147 401)**
NET INCOME AVAILABLE TO ORDINARY SHAREHOLDERS		**898 715**
Basic and diluted earnings per share, rubles	**6**	**0,30**

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

V.L. Gorbachev	S.G. Fefilova
General Director	Chief Accountant

Consolidated Statement of Cash Flows
for the year ended December 31, 2002

(In thousand rubles in terms of purchasing power of the ruble at December 31, 2001)

	2002
CASH FLOWS FROM OPERATING ACTIVITIES	
Income before taxation and minority interest	1 917 857
Adjustments for	
Foreign exchange loss, net	321 278
Net monetary gain	(470 666)
Depreciation and amortization	2 457 100
Loss on fixed assets disposals	74 199
Income from investments	(271 507)
Gain from sale of investments, net	(1 097 069)
Interest expense and similar items, net	335 503
Bad debt expense	123 179
	3 389 874
Increase in accounts receivable	(270 583)
Increase in inventory	(20 220)
Increase in other current assets	(290 305)
Increase in accounts payable and accrued liabilities	240 064
Interest paid	(225 922)
Income tax paid	(778 543)
CASH FLOWS PROVIDED BY OPERATING ACTIVITIES	2 044 365
CASH FLOWS FROM INVESTING ACTIVITIES	
Capital expenditures	(2 497 334)
Sales/(purchase) of investments and other non-current assets (Note 11)	1 306 196
Proceeds from sales of equipment	90 778
Interest received	6 898
Dividends received	13 562
CASH FLOWS USED IN INVESTING ACTIVITIES	(1 079 900)
CASH FLOWS FROM FINANCING ACTIVITIES	
Proceeds from borrowings	1 667 657
Repayment of borrowings	(2 273 510)
Dividends paid	(299 792)
CASH FLOWS USED IN FINANCING ACTIVITIES	(905 645)

MONETARY EFFECTS ON CASH AND CASH EQUIVALENTS	**(80 156)**
EFFECTS OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	**(115)**
DECREASE IN CASH AND CASH EQUIVALENTS	**(21 451)**
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR	**251 262**
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR	**229 811**

NON-MONETARY TRANSACTIONS:	
Property, plant and equipment acquired through vendor financing	**979 219**
Equipment received under finance lease contracts	**385 678**
Equipment contributions	**71 073**

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

V.L. Gorbachev
General Director

S.G. Fefilova
Chief Accountant

Consolidated Statement of Shareholders' Equity
for the year ended December 31, 2002

(In thousands of rubles in terms of purchasing power of the Ruble at December 31, 2002)

		Share capital (Nominal)				
	Notes	**Preference shares**	**Ordinary shares**	**Inflation impact on share capital**	**Retained Earnings and Other Reserves**	**Total Equity**
At December 31, 2001	**1**	**320 810**	**976 969**	**1 741 475**	**8 709 816**	**11 749 070**
Net income for the year		-	-	-	1 046 116	1 046 116
Dividends	**7**	-	-		(459 257)	(459 257)
Change in fair value of available-for-sale financial assets, net of tax		-	-	-	68 468	68 468
At December 31, 2002		**320 810**	**976 969**	**1 741 475**	**9 365 143**	**12 404 397**

The accompanyng notes form an integral part of these consolidated financial statements

V.L. Gorbachev
General Director

S.G. Fefilova
Chief Accountant

1. Corporate Information

Authorization of Accounts

The consolidated financial statements of OAO “Southern Telecommunications Company” and its subsidiaries (the “Company”) for the year ended December 31, 2002 were authorized for issue by its appointed General Director and Chief Accountant on July 31, 2003.

The Company

OAO “Kubanelectrosvyaz” (the Company’s legal predecessor) became a legal successor of State telecommunication enterprise. The Company was registered in the Russian Federation in accordance with the Decree of the Deputy of the Head of Administration of Krasnodar City No. 186-p dated May 20, 1994. In accordance with the decision of the annual shareholders’ meeting, OAO “Kubanelectrosvyaz” on June 28, 2001 was renamed OAO “Southern Telecommunications Company” (abbreviated name OAO “STC”). OAO “STC” was restructured into the merged multi-region company on November 1, 2002 through a merger with 9 other telecom enterprises located in the Southern Federal Region of the Russian Federation (see Note “2002 Reorganization” below). The Company is an open joint stock company incorporated in Russia.

The Company completed its last charter registration on January 21, 2003. This amendment was due to the process of reorganization described below.

The Company’s principal activity is providing local and long-distance and international telephone services, telegraph and data transfer services, including Internet. Other types of activity of the Company include production of telecommunication equipment and its technical support, motor transport repair and maintenance of recreational facilities and other social infrastructure. Associated companies provide cellular services in the Southern Federal Region of the Russian Federation.

Open joint-stock company Svyazinvest, a federal holding company majority-owned by the Russian Federation, owns 51% of the Company’s ordinary shares. Domestic and international long-distance telecommunication services are provided by OAO “Rostelecom”, a subsidiary of OAO “Svyazinvest”.

The average number of employees in the Company in 2002 was approximately 45 thousand persons (after giving retroactive effect of the reorganization described below), including subsidiaries.

The registered office of the Company is in the city of Krasnodar in the Russian Federation, 350000, Karasunskaya street, 66.

1. Corporate Information (continued)

2002 Reorganization

In 2001 the Company's management started the Company's reorganization by obtaining shareholder approval to merge the following regional enterprises of OAO "Svyazinvest", wherein 1,810,258 thousand ordinary and 588,742 thousand preference shares of the Company were exchanged for 100% of the outstanding shares of the regional enterprises as follows:

Regional Enterprise	Shares issued by the Company, thousands		Exchange Ratio
	Ordinary	Preference	
OAO "Electrosvyaz" of Adygeya Republic"	44,026,676	–	45.9300
OAO "Svyazinform" of Astrakhan Region"	148,513,485	49,503,645	4.5900
OAO "Volgogradelectrosvyaz"	502,266,342	167,422,099	17.7200
OAO "KabBalktelecom"	61,416,990	20,471,554	0.7000
OAO "Electrosvyaz" of Kalmykiya Republic"	21,114,547	7,038,243	60.4600
OAO "Karachaevo-Cherkesskelectrosvyaz"	14,714,885	4,904,976	17.7297
OAO "Rostovelectrosvyaz"	642,567,217	214,189,311	8.8700
OAO "Sevosetinelectrosvyaz"	123,680,792	41,219,624	8.0000
OAO "Electrosvyaz" of Stavropol Region"	251,943,205	83,981,261	82.9000
Total	**1,810,244,139**	**588,730,713**	

The merger was completed and effective on November 1, 2002. Transaction costs related to the merger incurred in 2002 were 55,448 and expensed.

While International Financial Reporting Standards do not specify accounting principles to be applied to transactions among entities under common control, the Company has accounted for the merger based on the principles of uniting of interests as described in IAS 22, "Business Combinations". In applying this method, the Company has reflected amounts in the consolidated financial statements at their historical carrying amounts as if the entities had been combined from January 1, 2002, the earliest period presented. Unless otherwise described, all information presented in these consolidated financial statements gives retroactive effective to the reorganization.

1. Corporate Information (continued)

2002 Reorganization (continued)

Based on the requirements IAS 22, the following table summarizes total assets, liabilities, revenue and pre-tax income (loss) for each of the regional operations for the year, in which the reorganization had been completed:

	Total assets	Total liabilities	Revenue	Pre-tax Income (loss)
"Southern Telecommunications Company"	6,224,344	2,052,123	3,831,558	1,424,951
"Electrosvyaz" of Adygeya Republic"	217,842	53,679	142,741	(16,994)
"Svyazinform" of Astrakhan Region"	764,235	301,364	577,770	55,720
"Volgogradelectrosvyaz"	4,368,973	1,593,038	1,829,508	192,614
"KabBalktelecom"	304,524	166,562	401,327	46,855
"Electrosvyaz" of Kalmykiya Republic"	168,040	35,860	110,103	7,343
"Karachaevo-Cherkesskelectrosvyaz"	264,398	153,833	183,410	(104,910)
"Rostovelectrosvyaz"	2,173,832	572,239	2,320,169	(52,758)
"Sevosetinelectrosvyaz"	749,283	229,220	603,707	89,414
"Electrosvyaz" of Stavropol Region"	4,366,938	1,891,555	1,885,077	275,622
Eliminations and other adjustments	(10,756)	(10,756)	–	–
Total	**19,591,653**	**7,038,717**	**11,885,370**	**1,917,857**

Before the restructuring in November 2002, the businesses operated as separate subsidiaries of OAO Svyazinvest. Accordingly, the Company has a limited operating history as a combined business.

Russian Business Environment

The Russian economy while deemed to be of market status beginning in 2002, continues to display certain traits consistent with that of a market in transition. These characteristics have in the past included higher than normal historic inflation, lack of liquidity in the capital markets, and the existence of currency controls, which cause the national currency to be illiquid outside of Russia. The continued success and stability of the Russian economy will be significantly impacted by the government's continued actions with regard to supervisory, legal, and economic reforms.

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

1. Corporate Information (continued)

Liquidity and Financial Resources

As of December 31, 2002, the Company's current liabilities exceeded its current assets by 2,438,713. As a result, significant uncertainties exist as to the Company's liquidity and future capital resources.

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

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

Through 2003, the Company anticipates funding from a) existing cash reserves, b) cash generated from operations, c) placement of ruble bonds in the Russian market, and d) other financing from domestic lending institutions. Management also expects to continue to be able to delay payment for certain operating costs to manage its working capital requirements if necessary.

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

2. Summary of Significant Accounting Policies

Basis of Preparation

The Company maintains its accounting records and prepares its statutory accounting reports in Russian Rubles and in accordance with the Regulations on Accounting and Reporting in the Russian Federation. The accompanying financial statements presented in accordance with International Financial Reporting Standards (IFRS) are based upon the statutory accounting records that are maintained in accordance with the Russian accounting regulations under the historical cost convention. These statutory accounting reports have been adjusted to present the accompanying financial statements in accordance with IFRS. IFRS include standards and interpretations approved by the International Accounting Standards Board (IASB), and International Accounting Standards and Standing Interpretations Committee interpretations approved by the International Accounting Standards Committee Foundation (IASCF) that remain in effect. Significant differences exist between Russian Accounting Regulations and IFRS.

2. Summary of Significant Accounting Policies (continued)

Basis of Preparation (continued)

The consolidated financial statements have been prepared on an historical cost basis (adjusted for the effects of inflation in accordance with IAS 29), except for the measurement at fair value of available-for-sale financial assets.

Prior to 2002, the Company presented financial statements in accordance with accounting principles generally accepted in the United States. These financial statements had been presented in US dollars.

In consideration of the 2002 reorganization, the Company changed to reporting its financial information in accordance with IFRS. As a result, these accounts reflect the first year that the Company has applied IFRS. As a result of the reorganization and the change in accounting, it was not practical for the Company to present comparative financial information for 2001 and determine retained earnings as of January 1, 2002.

Management Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Basis of Consolidation

The consolidated financial statements comprise the financial statements of the Company and its subsidiaries. As described elsewhere, the Company has accounted for the reorganization based on the principles of uniting of interests as described in IAS 22, "Business Combinations".

Subsidiaries are consolidated from the date on which control is transferred to the Company and cease to be consolidated from the date on which control is transferred from the Company. Significant intercompany balances and transactions have been eliminated. Minority interests reflect the interests in subsidiaries not held by the Company (see Note 10, *Investments in Subsidiaries*).

Investments in Associates

The Company's investments in its associates are accounted for under the equity method of accounting. This is an entity in which the Company has significant influence and which is neither a subsidiary nor a joint venture of the Company. The investment in associates are carried in the balance sheet at cost plus post-acquisition changes in the Company's share of net assets of the associates, less any impairment in value. The income statement reflects the Company's share of the results of operations of the associates.

2. Summary of Significant Accounting Policies (continued)

Interest in Joint Venture

The Company's interest in its joint venture is accounted for by proportionate consolidation, which involves recognizing a proportionate share of the joint venture's assets, liabilities, income and expenses with similar items in the consolidated financial statements on a line-by-line basis.

In respect of the Company's interest in jointly controlled assets, the Company recognizes in the consolidated financial statements its share of the jointly controlled assets, classified according to the nature of the assets; any liability which it has incurred; any income and expenses which it has incurred in respect of its interest in jointly controlled asset.

Accounting for the Effects of Inflation

The accompanying consolidated financial statements are prepared in accordance with IFRS under the historical cost convention and adjusted in accordance with IAS 29 "Financial Reporting in Hyperinflationary Economies" (IAS 29).

The adjustments and reclassifications made to the statutory records for the purpose of IFRS reporting include the restatement for changes in the general purchasing power of the ruble in accordance with IAS 29. IAS 29 requires that financial information prepared in the currency of a hyperinflationary economy be stated in terms of the measuring unit current at the balance sheet date. These adjustments were calculated using conversion factors derived from the Russian Federation Consumer Price Index ("CPI") published by the Russian State Committee on Statistics.

The indices used to adjust amounts in these consolidated financial statements with respect to 2002 prices (2002 = 1.0) for the years ended December 31, and the respective conversion factors, are:

Year	Index	Conversion factor
1992	7,541	362.4
1993	67,846	40.3
1994	211,612	12.9
1995	487,575	5.6
1996	594,110	4.6
1997	659,403	4.1
1998	1,216,401	2.2
1999	1,663,091	1.6
2000	1,997,843	1.4
2001	2,374,037	1.2
2002	2,733,087	1.0

2. Summary of Significant Accounting Policies (continued)

Accounting for the Effects of Inflation (continued)

The main guidelines followed in adjusting the consolidated financial statements to current purchasing power are:

- all amounts are stated in terms of the measuring unit current at December 31, 2002;
- monetary assets and liabilities at December 31, 2002 are not restated as they are already expressed in terms of the monetary unit current at December 31, 2002;
- non-monetary assets and liabilities which are not carried at amounts current at December 31, 2002 and shareholders' equity are restated by applying the relevant conversion factors;
- indexation adjustments to property, plant and equipment applicable to prior periods are credited to "Retained earnings and other reserves" in the accompanying balance sheet;
- all items in the consolidated statements of income and of cash flows are adjusted by applying appropriate conversion factors with the exception of depreciation, amortization and losses from disposal of fixed assets and other assets;
- the effect of inflation on the Company’s net monetary position is included in the consolidated statement of operations as a gain or loss on net monetary position.

Effective from January 1, 2003, international accounting and financial reporting bodies have determined that the Russian Federation no longer meets the criteria of IAS 29 for hyperinflation. As a result, management has determined that it will cease to restate for changes in the general purchasing power of the ruble subsequent to December 31, 2002. The annual rate of inflation during 2002 was 15.1%.

Foreign Currency Translation

Foreign currency assets and liabilities are translated into rubles at official Central Bank of the Russian Federation (CBR) exchange rates at the year end. Transactions denominated in foreign currencies are reported at the CBR rates of exchange at the date of the transaction. Any gains or losses on assets and liabilities denominated in foreign currencies arising from a change in official exchange rates after the date of transaction are recognized as currency translation gains or losses.

Transactions that are conducted in rubles when the related assets and liabilities are denominated in foreign currencies (or conventional units) are recorded in the Company’s financial statements on the same principles as transactions denominated in foreign currencies.

2. Summary of Significant Accounting Policies (continued)

Property, Plant and Equipment

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

Buildings and constructions	20-50 years
Analogue switches	10-20 years
Digital switches	10-15 years
Cable and transmission devices:	
Duct	10-20 years
Radio and fixed link transmission equipment	10-20 years
Vehicles	5 years
Computers, office and other equipment	3-5 years

Construction in progress is recorded as the total of actual expenses incurred by the Company from the beginning of construction to the reporting date, adjusted for the effect of inflation from the date when such expenses occur to the reporting date in accordance with IAS 29. Construction in progress is depreciated once put into operation.

Borrowing costs that are directly attributable to the acquisition or construction of fixed assets are capitalized as part of the cost of the related asset when it is probable that they will result in future economic benefits to the Company and the costs can be measured reliably. Capitalization of borrowing costs commences when the activities to prepare the asset for intended use start and lasts until the assets are ready for their intended use. Other interest expenses and borrowing costs are recognized as expenses in the period in which they are incurred.

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

The cost of maintenance, repairs, and replacement of minor items of property is charged to maintenance expense. Renewals and betterments are capitalized. Upon sale or retirement of property, plant and equipment, the cost and related accumulated depreciation are eliminated from the accounts. Any resulting gains or losses are included in the determination of net income.

2. Summary of Significant Accounting Policies (continued)

Property, Plant and Equipment (continued)

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

Equipment Contributions

Equipment transferred to the Company free of charge by its customers and other entities outside the privatization process is capitalized at market value at the date of transfer and a corresponding deferred income is recognized as a liability in the balance sheet and credited to the statement of operations on the same basis as the equipment is depreciated.

If contributions of equipment do not generate revenues such contributions are not recorded.

Grants received from municipal authorities for the purchase equipment are reflected in the balance sheet as deferred income and recognized as income during the useful life of a respective asset in accordance with IAS 20 "Accounting for Government Grants and Disclosure of Government Aid Information".

Intangible Assets

Intangible assets acquired separately from a business are capitalized at cost. Intangible assets acquired as part of an acquisition of a business are capitalized separately from goodwill if the fair value can be measured reliably on initial recognition, subject to the constraint that, unless the asset has a readily ascertainable market value, the fair value is limited to an amount that does not create or increase any negative goodwill arising on the acquisition. Intangible assets, excluding development costs, created within the business are not capitalized and expenditure is charged against profits in the year in which it is incurred.

The carrying values of intangible assets are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

Research and Development Costs

Research and development costs are expensed as incurred.

2. Summary of Significant Accounting Policies (continued)

Investments

All investments are initially recognized at cost. After initial recognition, investments which are classified as held for trading and available-for-sale are measured at fair value. Gains or losses on investments held for trading are recognized in income. Gains or losses on available-for-sale investments are recognized as a separate component of equity until the investment is sold, collected or otherwise disposed of, or until the investment is determined to be impaired, at which time the cumulative gain or loss previously reported in equity is included in income.

Other long-term investments that are intended to be held-to-maturity, such as bonds, are subsequently measured at amortized cost using the effective interest rate method.

The majority of the Company's investments are in securities that are not actively traded on organized financial markets. Management believes that fair value for these investments approximates their carrying amount.

Inventories

Inventories are priced at the lower of cost or net realizable value. Cost is determined primarily using the specific identification method.

Accounts Receivable

Accounts receivable are stated at face value, less an allowance for doubtful accounts. An estimate of doubtful debts is made when collection of the full amount is no longer probable.

Cash and Cash Equivalents

Cash and cash equivalents represent cash on hand and in the Company's bank accounts, as well as cash deposits and short-term investments with original maturity dates of 3 months or less as of December 31, 2002.

Interest-Bearing Loans and Borrowings

All loans and borrowings are initially recognized at cost. After initial recognition, interest-bearing loans and borrowings, are subsequently measured at amortized cost using the effective interest rate method.

Non Interest-Bearing Loans and Borrowings

Non interest-bearing loans and borrowings are carried at their fair market value estimated by discounting future payments to their present value. Weighted average interest rates are used as an approximation to market interest rates.

2. Summary of Significant Accounting Policies (continued)

Provisions

Provisions are recognized when the Company has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the Company expects a provision to be reimbursed, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain. If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as an interest expense.

Pensions and Other Post-employment Benefits

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

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

Under collective bargaining agreements, the Company also provides post-employment retirement benefits. The majority of the Company’s employees are eligible to participate under such defined benefit plans based upon a number of factors, including years of service, age and compensation. In addition, the Company has noncontributory defined benefit retirement plans, which provides for a lump-sum payment of 0.5 – 2 monthly wages upon retirement.

The Company has not complied with IAS 19, “Employee Benefits”. Specifically, the Company has not made an actuarial determination of the present value of its benefit obligation under these arrangements to allow it to record its obligation and make the required disclosures under IAS 19 as of December 31, 2002.

In order to fund a portion of the Company’s obligation, the Company also participates in plans under which the Company has committed to contribute agreed amounts (negotiated annually) to certain non-government pension plans. Contributions made by the Company to these on defined contribution plans are charged to expense when incurred.

2. Summary of Significant Accounting Policies (continued)

Leases

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

Capitalized leased assets are depreciated over the shorter of the estimated useful life of the asset or the lease term.

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

Revenue

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

The Company categorizes its revenue sources in ten major categories:

1. Monthly subscription fees;
2. Long distance services;
3. Rent of channels;
4. Installation fees;
5. Internet services;
6. Radio broadcasting;
7. Rent of assets;
8. Telegraph services;
9. Other telecommunication services;
10. Other revenue.

Monthly subscription fees
The Company recognizes revenues related to the monthly network fees in the month that the service is provided to the subscriber.

Long distance services
Revenues from long distance services are based on time used by the caller, the destination of the call and the services utilized. The Company charges long distance fees on a per-minute basis. The Company recognizes revenues related to the long distance services in the period when the services are rendered.

2. Summary of Significant Accounting Policies (continued)

Revenue (continued)

Rent of channels
The Company provides other telecommunication operators with access to its network. The Company recognizes revenues related to rent of channels in the period when the services were rendered.

Installation fees
The Company recognizes installation fees for indefinite contracts with its subscribers as revenues when the installation is complete.

Internet services
The Company recognizes revenues related to the Internet services in the period when the services are rendered.

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

Rent of assets
The Company leases its premises to other businesses mostly under annual contracts. Renewal options are available on the majority of leases. These contracts are accounted for as operating leases and related rental revenues are recognized over the lease term.

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

Other telecommunication services
Other telecommunication services mainly include revenues from payphones network, rent of channels and data transmission.

Other revenue
Revenues other than telecommunication revenues primarily consist of revenue from production of telecommunication equipment and its technical support, transportation services, maintenance of recreational facilities and other social infrastructure and sale of goods and services provided by non-core units, and sales of other assets.

2. Summary of Significant Accounting Policies (continued)

Income Tax

Deferred tax assets and liabilities are calculated in respect of temporary differences in accordance with IAS 12 "Income Taxes".

IAS 12 requires the use of a balance sheet liability method for financial reporting and accounting for deferred income taxes. Deferred income taxes are provided for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes. The Company’s principal temporary differences arise in respect of property, plant and equipment. A deferred tax asset is recorded only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilized.

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

Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realized or the liability settled based on tax rates that have been enacted or substantively enacted at the balance sheet date.

Deferred tax liabilities relating to undistributed earnings of associated companies are recognized when it is probable that such earnings will be remitted to the Company in the foreseeable future.

Value-added Tax

Value-added taxes related to sales are payable to the tax authorities on an accrual basis based upon invoices issued to the subscriber. VAT incurred for purchases and paid to suppliers may be reclaimed, subject to certain restrictions, against VAT related to sales. VAT related to purchase transactions that are not currently reclaimable as of the balance sheet date are recognized in the balance sheet on a gross basis.

3. Segment Information

OAO ”Southern Telecommunications Company” operates in one industry, i.e. provision of wireline telecommunication services, on the territory of South region of Russia. The Company’s structure is based on territorial units, which service the corresponding parts of the Company’s network. The Company’s management considers that the Company operates in one geographical and business segment, and evaluates performance and makes investment and strategic decisions based upon a review of profitability for the Company as a whole.

4. Revenues and Expenses

Revenues

	2002
Domestic long-distance services	4,821,309
Monthly subscription fees	2,607,342
International long-distance services	1,041,407
Installation fees	1,040,367
Telegraph services	195,622
Data transmission services	380,978
Radio broadcasting	166,439
Other telecommunication services	944,727
Other revenue	687,179
Total	**11,885,370**

Other telecommunication services mainly include revenues from lease of channels, payphones exploitation and sales of handsets and accessories.

Revenues other than telecommunication revenues primarily consist of revenue from production of telecommunication equipment and its technical support, transportation services, maintenance of recreational facilities and other social infrastructure and goods and services provided by non-core subsidiaries.

For the year ended December 31, 2002, the Company identified revenue by these major customer groups:

	2002
Residential customers	5,913,180
Corporate customers	3,635,545
Government customers	2,336,645
Total	**11,885,370**

4. Revenues and Expenses (continued)

Other Operating Expenses

	2002
Cost of goods sold	174,321
Rent (excluding channel rent)	98,240
Consulting and audit	80,931
Advertising	22,083
Loss in carrying value of inventory and other current assets	12,594
General and administrative expenses	281,082
Other expenses	288,355
Total	**957,606**

General and Administrative Expenses

	2002
Security expenses	93,135
Payments to Gossvyaznadzor	69,326
Transportation	65,382
Post	27,370
Representative and business trip expenses	14,726
Other general and administrative expenses	11,143
Total	**281,082**

5. Income Tax

Income Tax Expense

	2002
Current tax charge	757,903
Deferred tax charge	19,529
Income tax charge	**777,432**

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

	2002
Profit from operating activities before income tax	1,917,857
At statutory income tax rate of 24%	460,286
Effect of:	
Expenses not deductible for tax purposes	24,872
Non-taxable gains	(4,970)
Currency gains and losses	866
Permanent elements of monetary gain	370,439
Inflation effect on deferred tax balance at beginning of year	(20,289)
Other reconciling items	(53,772)
At effective income tax rate of 41%	777,432

5. Income Tax (continued)

Deferred Income Tax

	Balance Sheet 2002
Deferred income tax assets	
Accounts payable	52,740
Accounts receivable	46,475
Other	26,674
Gross deferred income tax assets	125,889
Deferred income tax liabilities:	
Property, plant and equipment	(710,271)
Inventories	(33,744)
Investments	(66,511)
Gross deferred income tax liabilities	(810,526)
Net deferred income tax liability	(684,637)

6. Earnings per Share

Basic and diluted earnings per share are calculated by dividing the net profit for the year attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the year. Ordinary shares issued as part of the reorganization, that has been accounted for similar to a uniting of interests, are included in the calculation of the weighted average number of shares from January 1, 2002 as the financial statements of the Company are prepared as if the combined entity had existed as from that date. Therefore, the number of ordinary shares is the aggregate of the weighted average number of shares of the combining entities, adjusted to equivalent shares of the Company outstanding after the reorganization.

	2002
Net income attributable to ordinary shareholders for basic and diluted EPS	898,715
Weighted average number of ordinary shares for basic and diluted EPS	2,960,512,964
Earnings per ordinary share, rubles (basic and diluted)	**0.30**

The Company has no potential dilutive shares outstanding.

There have been no other transactions involving ordinary shares or potential ordinary shares since the reporting date and before the completion of these financial statements.

7. Dividends Paid and Proposed

Declared in 2002 (for the year 2001)

Dividends on ordinary shares	311,856
Dividends on preference shares	147,401
Total	**459,257**

Approved by the annual shareholder meeting for the year ending 2002 (See Note 27, Subsequent Events)

Dividends on ordinary shares	240,394
Dividends on preference shares	156,225
Total	**396,619**

Dividends paid to shareholders are determined by the directors and legally declared and approved at the annual shareholders' meeting. Earnings available for dividends are limited to profits determined in accordance with Russian statutory accounting regulations.

8. Property, Plant and Equipment

	Buildings and constructions	Switches and transmission devices	Assets under construction and equipment awaiting installation	Machines and Other	Total
Cost					
As of January 1, 2002	16,027,438	19,841,579	955,972	3,993,774	40,818,763
Additions	–	–	3,803,238	–	3,803,238
Disposals	(196,806)	(141,712)	(39,254)	(107,246)	(485,018)
Transfers	1,268,188	1,786,982	(3,541,790)	486,620	–
As of December 31, 2002	**17,098,820**	**21,486,849**	**1,178,166**	**4,373,148**	**44,136,983**
Impairment					
As of January 1, 2002	(2,857,743)	(2,005,516)		(86,537)	(4,949,796)
Charge for the year	–	–		–	–
Recoveries/reversals	20,601	20,851		1,585	43,037
As of December 31, 2002	**(2,837,142)**	**(1,984,665)**		**(84,952)**	**(4,906,759)**
Accumulated Depreciation					
As of January 1, 2002	(7,245,090)	(9,977,820)	–	(3,328,412)	(20,551,322)
Charge for the year	(619,740)	(1,385,915)	–	(449,331)	(2,454,986)
Depreciation on disposals	110,717	91,396	–	70,228	272,341
As of December 31, 2002	**(7,754,113)**	**(11,272,339)**		**(3,707,515)**	**(22,733,967)**
Net book value as of December 31, 2002	**6,507,565**	**8,229,845**	**1,178,166**	**580,681**	**16,496,257**

8. Property, Plant and Equipment (continued)

The carrying value of plant and equipment held under finance leases at December 31, 2002 is 420,690. Leased assets are pledged as security for the related finance lease liabilities (see Note 20, *Obligations under Finance Leases*).

The total interest costs capitalized during 2002 amounted to 22,506.

Buildings and equipment with a book value of 3,238,958 as of December 31, 2002 secure borrowings until the last installment is paid (see Note 19, *Loans and Borrowings*).

The Company's accounting records relating to fixed assets are not designed to support their presentation in accordance with IAS 16, "Property, Plant and Equipment", IAS 29, "Financial Reporting in Hyperinflationary Economies" and IAS 36, "Impairment of Assets". As such, certain estimates were made by management to present fixed assets in the accompanying financial statements.

In the future, the Company expects to hire an independent appraiser to assist in reconstruction of the historical cost of the Property, Plant and Equipment, in order to make the necessary adjustments, if any, to the Company's books and records, in order to comply with IFRS.

9. Intangible Assets

	Licenses	Software	Other	Total
Cost				
At January 1, 2002	2,856	9,085	442	12,383
Additions	–	643	–	643
Disposals	–	–	(2)	(2)
At December 31, 2002	2,856	9,728	440	13,024
Accumulated amortization				
At January 1, 2002	(1,720)	(2,532)	(20)	(4,272)
Charge for the year	(515)	(1,511)	(88)	(2,114)
Disposals	–	–	–	–
At December 31, 2002	(2,235)	(4,043)	(108)	(6,386)
Net book value at December 31, 2002	**621**	**5,685**	**332**	**6,638**

Licenses and software are being amortized evenly over their useful lives determined based on terms of license or license agreement for software. Useful lives of other intangible assets are 5 years.

10. Investments in Subsidiaries

The consolidated financial statements include the financial statements of OAO “Southern Telecommunication Company” and the significant subsidiaries listed in the following table:

Subsidiary	Main activity	Voting shares 2002
ZAO “Autocenter-Yug”	Transport	100%
DZAO “Armavirskiy Zavod Svyazi”	Production of cable	100%
ZAO “Recreational House “Orbita”	Recreation services	100%
ZAO “CMTO”	Supply of materials	100%
ZAO “Yugsvyazstroy”	Construction services	100%
ZAO “Telesot-Alaniya”	Cellular telecommunication services (GSM-900)	53%
OAO “Stavtelecom named after V.I. Kuzminov” (hereinafter OAO “Stavtelecom”)	Fixed line telecommunication services, data transfer	51%
OOO “Intmashservice”	Repair and maintenance of telecommunication equipment	100%
OOO “Factorial-99”	Information and intermediary services, consulting	100%

All the above-mentioned companies are Russian legal entities registered in accordance with Russian regulations.

11. Investments in Associates

Associate	Main activity	As of December 31, 2002 Carrying amount	Voting shares
ZAO “Volgograd-Mobile”	Cellular communications services AMPS (800 MHz)	47,596	50%
ZAO “Volgograd GSM”	Cellular communications services (GSM)	244,644	50%
ZAO “Stavropolskaya Sotovaya Svyaz”	Cellular communications services AMPS (800 MHz)	18,684	50%
ZAO “Teleross-Kubanelectrosvyaz”	Local and long-distance communication services.	8,294	50%
ZAO “Astrakhan-Mobile”	Cellular communications services AMPS (800 MHz)	-	50%
ZAO “Teleross-Volgograd”	Fixed line communication services.	3,472	50%
ZAO “ZanElCom”	Development, installation and maintenance of regional system of networking information technologies.	24	45%
ZAO “Sotovaya Svyaz-Alaniya”	Cellular communications services NMT-450 MHz	240	30%
OAO “SKET”	Commercial television	314	45%
ZAO “Telekinocompaniya “IR”	Commercial tele- and radio-broadcasting.	10	24%
ZAO “Kabardino-Balkarskiy GSM”	Cellular communication services, GSM-900	629	20%
ZAO “Karachaevo-CherkesskTeleSot”	Cellular communication services, GSM-900	57	20%
Total		**323,964**	

On December 28, 2001 STC and OAO “Mobile TeleSystems” entered into preliminary agreement for the sale of the Company’s 24% stake in ZAO “Kuban GSM”. The sale was completed in March 2002 for USD 33.6 million (approximately 1 billion rubles).

12. Available-for-sale Financial Assets and Other Long-Term Assets

Available-for-sale financial assets and other long-term assets as at December 31, 2002 were primarily comprised of a 10% share in ZAO "Stavtelesot". This investment does not have a quoted market price in an active market. Management has estimated the fair value of its interest based on the sale of an indirect interest subsequent to December 31, 2002 (see Note 27, *Subsequent Events*).

13. Interests in Joint Ventures

Joint Venture with ZAO Westelcom

The Company has a 50% interest in a joint venture with ZAO Westelcom, which is involved in the construction of a digital overlay network in Adygeya republic and joint commercial usage of it. The joint venture agreement, concluded in November 1995, is valid during ten years and may be subsequently prolonged.

The Company's share of the assets, liabilities, revenue and expenses of the joint venture, which are included in the consolidated financial statements under proportionate consolidation method, are as follows at December 31, 2002 and for the year then ended:

	2002
Non-current assets	11,593
Current assets	4,447
	16,040
Current liabilities	(14,837)
	1,203
Revenue	31,166
Operating expenses	(29,610)
Net profit	1,556

Joint activity with OAO Svyazinvest

On February 13, 1998 the Company entered into a joint activity agreement with Svyazinvest. In accordance with the terms of the agreement the Company should construct a swimming pool at the rest-house 'Orbita' (the Company's wholly-owned subsidiary). Svyazinvest contributed 52.5% of investments (approximately 73 million, or 18 million in terms of purchasing power of ruble at the date of investment), and 47.5% of investments (approximately 66 million, or 16 million in terms of purchasing power of ruble at the date of investment) were contributed by the Company.

In accordance with the initial terms of the agreement, the construction should have been completed by June 30, 1999, and in case of non-compliance with the agreement, the Company is obliged to pay the penalties to Svyazinvest at the rate of the Central Bank of the Russian Federation for the period from the contribution date.

Following the Russia economic crisis in 1998 the construction works were ceased and remain uncompleted at December 31, 2002.

13. Interests in Joint Ventures (continued)

Joint activity with OAO Svyazinvest (continued)

In 2002 the Company’s Board of Directors approved to terminate the joint activity agreement. The final arrangements were made on March 27, 2003 when the Novation Agreement between Svyazinvest and the Company was concluded. In accordance with the agreement reached, for fulfillment of the terms of the Novation Agreement, the Company issued non-interest bearing promissory notes for the amount of 37,868 to Svyazinvest. These notes mature in the period from July 1, 2003 until December 1, 2003. The Company’s obligation is presented as Provision in the accompanying consolidated balance sheet as at December 31, 2002 (see Note 22, *Provisions*).

14. Inventories

Inventories at December 31, 2002 comprised the following:

	2002
Cable, materials and spare parts for telecommunication equipment	630,042
Finished goods and goods for sale	50,526
Provision for obsolescence	(22,235)
Total	**658,333**

15. Trade Accounts Receivable

Accounts receivable at December 31, 2002 comprised the following:

	2002
Trade receivables – telecommunication services	978,518
Trade receivables – other	37,363
Less allowance for doubtful accounts	(162,602)
Total	**853,279**

As of December 31, 2002, the Company identified trade receivables by the following major customer groups:

	2002
Residential customers	412,122
Corporate customers	410,528
Government customers	155,868
Total	**978,518**

15. Trade Accounts Receivable (continued)

The Company invoices its governmental and corporate customers on a monthly basis. For residential customers, the Company sends monthly payment requests and substantially relies upon these customers to remit payments based on the received payment requests. All customer payments are based upon tariffs, denominated in rubles, in effect at the time of calls made. In circumstances of delay, the Company has billed and collected penalties associated with delays in payment and has been able to obtain payments through the Arbitrage Court. In order to further reduce a portion of the risk associated with customer nonpayments, the Company has in certain circumstances negotiated arrangements wherein the Company has accepted payment in goods and services, which are utilized in carrying out its non-core business.

16. Other current assets

Other current assets at December 31, 2002 comprised the following:

	2002
Prepayments and advances	92,462
Settlements with personnel	13,969
VAT	243,430
Taxes prepaid	101,529
Notes receivable	5,400
Other receivables	72,753
Less: Provision for other current assets	(47,558)
Total	**481,985**

17. Cash and Cash Equivalents

	2002
Cash at bank and in hand	206,232
Short-term bank deposits	18,573
Other	5,006
Total	**229,811**

The fair value of cash and cash equivalents equals its book value.

18. Share Capital

Share capital:	2002	
	Shares	Share capital
Preference shares, 0.33 rubles par value		
Shares issued and outstanding as of December 31, 2002	972,151,838	320,810
Shares authorized, not issued	32,711,532	
Ordinary shares, 0.33 rubles par value		
Shares issued and outstanding as of December 31, 2002	2,960,512,964	976,969
Shares authorized, not issued	130,814,345	
Total share capital		**1,297,779**

The state registration of the new edition of the charter documents was completed on January 23, 2003. In accordance with IAS 10, *Events After the Balance Sheet Date*, such changes of the charter capital were recognized as of December 31, 2002 in the accompanying financial statements.

The share capital account represents the authorized capital of the Company as stated in the charter documents. The Company had 2,960,512,964 ordinary shares and 972,151,838 preference shares type A issued as of December 31, 2002. All shares have a par value of 0.33 rubles. All shares are fully paid.

Of the capital shares issued as of December 31, 2002, 75.28% was attributable to ordinary shares and 24.72% attributable to preference shares, type A. The ordinary shareholders are allowed one vote per share. Preference shares type A are non-voting, except for the limited circumstances provided by the legislation of the Russian Federation. All ordinary shares and preference shares type A are eligible for distribution of earnings available in accordance with Russian statutory accounting regulations. Preference shares type A are entitled to a minimum annual dividend in the amount equal to 10% of statutory net income available for dividends. Annual dividends on preference shares are distributed among the preference shares issues and outstanding excluding treasury shares. Dividends on preference shares type A may not be less than the dividends on ordinary shares. Shareholders of preference shares type A have a preference right to recover the par value of preference shares in liquidation.

In February 1998, the Company concluded a Depositary Agreement with Bank of New York in respect of American Depositary Receipts (ADRs), Level 1. The issue was registered on February 5, 1998, and on April 23, 2002 the ADRs of the Company were transferred from Bank of New York to JP Morgan Chase Bank. The depositary agreement between the Company and JP Morgan Chase Bank was concluded on April 22, 2002 and revised on December 15, 2002 in accordance with the reorganization (see Note 1, *Corporate Information*). In accordance with the depositary agreement each ADR is equal to 50 ordinary shares of the Company. As at December 31, 2002, 1,147,903 ADRs represented 57,395,150 deposited ordinary shares, which constituted 1.94 % of total ordinary shares issued and outstanding.

18. Share Capital (continued)

The following represents the Company’s shareholders as of December 31, 2002 (in thousands of shares):

	Ordinary shares		Preference shares		Total
		%		%	
OAO “Svyazinvest”	1,500,671	50.69	–	–	1,500,671
Other legal entities	1,054,608	35.62	705,215	72.54	1,759,823
Individuals	405,234	13.69	266,937	27.46	672,171
Total:	**2,960,513**	**100**	**972,152**	**100**	**3,932,665**

19. Loans and Borrowings

As of December 31, 2002 borrowings consisted of the following:

	Interest rate range (%)	Maturity	2002
Short-term borrowings			
Sberbank RF	16-24	2003	474,868
AKB “Bank Moscow”	18	2003	170,000
OAO “Alfa Bank”	19-21	2003	55,000
OAO AKB “Volgoprombank”	21	2003	39,000
Yuginvestbank (promissory notes)	20	2003	30,000
FG VEB Invest (promissory notes)	16	2003	41,499
OAO AKB “Yugbank”	18-21	2003	32,000
OAO “Svyazinvest”	–	2003	11,212
Other	0-30%	2003	32,555
Total short-term borrowings			**886,134**

19. Loans and Borrowings (continued)

Long-term borrowings			
a) loans			
Sberbank RF	18–19	2004	163,293
OAO "AB "Incombank"	–	2004	220,799
OAO "Alfa-Bank"	7	2004	130,208
OAO "Svyazinvest"	11	2003	39,784
OAO "VKA Bank"	19	2006	34,104
ZAO "Stavtelesot"	–	2011	28,942
Other	0-21	2002-2007	56,302
Total long-term loans			673,432
b) supplier loans			
Vnesheconombank	8.5	2007	1,069,494
Siemens Group	6	2008	150,788
Iskratel (Slovenia)	7	2004	125,551
OOO "Center of Economic Development"	7	2005	124,952
OAO "Alfa-Bank"	7	2004	96,702
Ericsson Nicola Tesla	7	2004	84,794
ZAO "Lucent Technologies"	8	2006	80,403
ZAO "Nec-Neva KS"	7	2004	38,257
Other	7-19	2002-2008	121,132
Total long-term supplier loans			1,892,073
Total long-term borrowings			**2,565,505**
Less: current portion of long-term borrowings			(1,626,756)
Total			**938,749**

Short-term borrowings
Short-term ruble borrowings mainly represent bank loans received for working capital financing purposes.

Short-term loans from Svyazinvest (see Note 25, *Related Party Disclosures*) are represented by two non-interest bearing loans granted to finance reconstruction of the Company's network in Republic of Kabardino-Balkaria. The loans are not secured. As at December 31, 2002 8,212 of the outstanding amount was overdue.

19. Loans and Borrowings (continued)

Long-term borrowings

Sberbank

The Company's long term borrowings from Sberbank are represented mainly by the 150,000 ruble-denominated loan granted in November 2002, which matures in July 2004. Interest is accrued at 18% per annum. Telecommunication equipment for the amount of net book value of approximately 200 million rubles were pledged as a collateral for this loan.

Incombank

On February 25, 1998, the Company entered into a loan agreement with Incombank for the amount of 11,886 thousand Deutsche Mark (DM) repayable in until February 25, 2003. On August 21, 1998 the maturity was extended to July 20, 2004.

Equipment for the amount of approximately 400 million rubles, investments in 10% of shares in Stavtelesot and in 51% of shares in Stavtelecom were pledged as a collateral for this loan.

In accordance with the initial terms of the agreement, interest was accrued at six months DM FIBOR plus 6.25%.

Following the economic crisis of 1998 and the substantial increase of exchange rate of DM to ruble, in 1999 the Company requested cancellation of the loan agreement and changing the terms of agreement so that the payments should be executed in rubles translated at exchange rate as of the date of receipt of loan. As at December 31, 2002 the amount to be repaid and terms of the repayment were still in dispute. The loan is classified in the accompanying consolidated balance sheet in accordance with its initial repayment schedule (considering the Addendum to the agreement dated August 21, 1998).

Management believes that carrying amount of liability in the accompanying consolidated balance sheet approximates the amount that will be repaid upon final resolution of the dispute (see also Note 27, *Subsequent Events*).

Alfa Bank

On April 18, 1997, the Company entered into an agreement with Italtel S.p.a. (Italy), under which Italtel S.p.a. delivered telecommunication equipment to the Company. On September 24, 2001, Alfa Bank purchased the amounts due to Italtel S.p.a. under the vendor financing agreement, including accrued interest and penalties. The amounts payable under this agreement are denominated in USD and are repayable in installments during 2003 and 2004. The agreement does not provide for interest charges. The amount of liability included in accompanying consolidated balance sheet as at December 31, 2002 represents the present value of future payments under the agreement and equals 96,702. The Company recognized imputed interest attributable to this borrowing at a weighted average interest rate on the Company's interest bearing borrowings denominated in USD, which in 2002 approximated 7% per annum. The loan is not secured.

19. Loans and Borrowings (continued)

Alfa Bank (continued)

On December 19, 2001, the Company entered into a loan agreement with Alfa Bank for the amount of USD 6,517 thousand (approximately 205 million rubles). The loan is repayable in equal installments up to October 20, 2004. Interest is accrued at 7% per annum. The liability under this agreement included in the accompanying consolidated balance sheet as at December 31, 2002 amounted to 130,208. The loan is not secured.

Svyazinvest

In October 2001, the Company sold three ruble-denominated promissory notes with face value totaling 35,000 to Svyazinvest. The notes mature on different dates in 2002 and 2003. Interest is accrued at 11%. No repayments of principal amount in 2002 occurred. As a result, two of these notes totaling 26,413, which were included in current portion of long term debt in the accompanying consolidated balance sheet as at December 31, 2002 are overdue. Management believes that no penalty payments will be requested by Svyazinvest.

Stavtelesot

In 1997 the Company concluded an agreement with Stavtelesot, under which Stavtelesot provided the Company a non-interest bearing loan. In accordance with the initial agreement, the loan matures in 2011. The loan is not secured.

Vnesheconombank

The indebtedness represents the Company's liability payable in favor of the Government of the Russian Federation per amounts paid from the Russian federal budget to a foreign bank in connection with the funds provided by the latter for payments under equipment delivery contracts concluded by the Company and foreign suppliers in 1995-1996. Payments to the foreign bank (resident in the equipment supplier's jurisdiction) must be made pursuant to a loan agreement between the foreign bank and Vnesheconombank acting as the agent of the Government of the Russian Federation. All settlements are made by the Company through Vnesheconombank.

In accordance with the contractual terms, this liability was initially denominated in Deutsche Marks and subsequently, following the introduction of the European currency, redenominated in Euro. Interest is accrued at the Plafon-S floating interest rate (approximately 6.5% in 2002) increased by 2 percentage points. The liability is unsecured.

Following the 1998 crisis and a significant appreciation of the Deutsche Mark against rubles, payments under the above contracts were suspended, and approximately RUR 578 million of the total liability to Vnesheconombank included in the current portion of long-term loans in the accompanying consolidated balance sheet as of December 31, 2002, became overdue. At present, the Company is negotiating a restructuring of this liability (see Note 27, Subsequent Events).

19. Loans and Borrowings (continued)

Siemens

On December 14, 1995, the Company entered into an agreement with Siemens AG (Germany), under which Siemens AG delivered and installed telecommunication equipment to the Company. The amounts payable under this agreement are denominated in Euro and are repayable in equal installments during 2003-2008. Interest is accrued at 6% per annum. The loan is not secured.

Iskratel

The Company's long-term liabilities to Isrkatel are mainly represented by the amounts payable to Iskratel (Slovenia) for equipment. The amounts payable under this agreement are denominated in USD and are repayable in installments during 2003 and 2004. The agreement does not provide for interest payments. The amount of liability as at December 31, 2002 under this agreement amounting to 125,551 represents the present value of future payments under the agreement. The Company recognized imputed interest attributable to this borrowing at a weighted average interest rate on the Company's interest bearing borrowings denominated in USD, which in 2002 approximated 7% per annum. The loan is not secured.

Center of Economic Development

In 2001 and 2002 the Company entered into various agreements with Center of Economic Development (hereinafter "the Center"), under which the Center delivered telecommunication equipment to the Company. Related liability is denominated in USD. Part of these loans bear interest at 8% per annum. The amount of non-interest bearing loans as at December 31, 2002 represents the present value of future payments under the agreements. Interest is accrued at a weighted average interest rate on the similar interest bearing borrowings of the Company denominated in USD, which in 2002 approximated 7% per annum. The loans are not secured.

Ericsson Nicola Tesla

On January 24, 2001, the Company entered into an agreement with Ericsson Nicola Tesla (Croatia), under which Ericsson Nicola Tesla delivered telecommunication equipment to the Company. The amounts payable under this agreement are denominated in USD and are repayable in installments during 2003 and 2004. The agreement does not provide for interest payments. The amount of liability as at December 31, 2002 represents the present value of future payments under the agreement. The Company recognized imputed interest attributable to this borrowing at a weighted average interest rate on the similar interest bearing borrowings of the Company denominated in USD, which in 2002 approximated 7% per annum. The loan is not secured.

20. Obligations under Finance Leases

The Company has finance lease contracts for telecommunication equipment. Future minimum lease payments under finance lease contracts together with the present value of the net minimum lease payments as of December 31, 2002 are as follows:

	Minimum payments	Present value of payments
Within one year	181,865	112,901
After one year but not more than five years	322,233	225,659
Total minimum lease payments	504,098	
Less amounts representing finance charges	(165,538)	
Present value of minimum lease payments	338,560	338,560

In 2002 the major Company's lessors were Promsvyazleasing and RTC-Leasing (see also Note 25, *Related Parties Disclosures*). Effective interest rate on finance leases in 2002 varies between 25% and 36% per annum.

In accordance with the agreements with RTC-Leasing, the lessor has a right to adjust schedules of future lease payments subject to certain changes in economic environment, in particular, change in the refinancing rate of the Central Bank of the Russian Federation.

21. Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses at December 31, 2002 comprised the following:

	2002
Trade accounts payable	343,931
Advances received from subscribers	219,886
Accrued liabilities	34,856
Accounts payable for capital investments	374,845
Salaries and wages payable	182,474
Other accounts payable	186,266
Total	**1,342,258**

As of December 31, 2002, the Company identified the following taxes and social security payable:

	2002
Value added tax	226,728
Profit tax	47,955
Property tax	40,108
Personal income tax	37,694
Sales tax	39,827
Unified social tax	71,548
Other taxes	40,313
Total	**504,173**

22. Provisions

A provision is recognized for amounts payable to Svyazinvest for non-fulfillment terms of joint activity agreement, based on interest at 25 % per annum. The joint activity agreement was terminated in March 2003. It is expected that the liability to Svyazinvest will be paid during the period of July 1, 2003 to December 31, 2003. See also Note 13, *Interests in Joint Ventures*.

As at January 1, 2002	**40,580**
Adjustment to provision on signing of final cancellation agreement	2,618
Monetary gain	(5,330)
As at December 31, 2002	**37,868**

Adjustment to provision in the amount of 2,618 is included in other income and expenses in the accompanying consolidated statement of operations for the year ended December 31, 2002.

23. Pension Plans and Employee Benefits

In 2002, the Company made various payments to employees in addition to salary. These payments generally represent financial aid to the Company's employees with limited abilities and bonuses to employees, which had made no breaches of internal policies during the last fiscal year. Such benefits were included in salary, benefits, salary taxes and other social expenditures in the accompanying consolidated statement of operations for the year ended December 31, 2002 and approximated 156 million rubles.

In addition to statutory pension benefits, the Company also contributes to defined benefit plans, which cover most of its employees. Non-government pension fund "Telecom-Soyuz" and non-government pension fund of Stavropol Region, which are not related to the Company, maintain the plans. The plans provide for payments of retirement benefits starting from statutory retirement age, which is currently 55 for women and 60 for men. The benefits are based on a formula recognizing minimal statutory pension level, length of service, both in the Company and in the telecommunications industry as well as final average earnings and position in the Company. The benefits are not vesting and are subject to the employee retiring from the Company on or after the above-mentioned respective ages. The Company makes contributions to the pension funds in the amounts representing fixed percentage of participating employees' salaries or in amounts fixed in the agreements with pension funds, depending on the nature of each particular agreement.

As described in Note 2, *Summary of Significant Accounting Policies*, the Company has not made an actuarial determination of the present value of its benefit obligation under these arrangements to allow it to record its obligation and plan asset and make the required disclosures under IAS 19, Employee Benefits, as of December 31, 2002.

24. Commitments and Contingencies

Insurance Coverage

The Russian insurance industry is in a developing state and many forms of insurance protection common in other parts of the world are not yet generally available. During 2002, the Company did not maintain insurance coverage on a significant part of their property, plant and equipment asset bases, business interruption, or third party liability in respect of property or environmental damage arising from accidents on the Company’s property or relating to the Company’s operations. Until the Company obtains adequate insurance coverage, there is a risk that the loss of destruction of certain assets could have a material adverse effect on the Company’s operation and financial position.

Litigation, Claims and Assessments

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

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

Capital Investment Commitments

As of December 31, 2002 the total contractual commitments of the Company for capital investments in modernization and expansion of its network were approximately 463,791, net of VAT, including 245,883 to be made under finance lease agreements. Management believes that other investments will be mostly financed by vendor financing and bank loans.

Finance Lease

On October 14, 2002, the Company issued a guarantee for loans received by RTC-Leasing (see Note 25, *Related Party Disclosures*) from Sberbank under a non-revolving credit line facility in the amount of 313,590. The loans were received by RTC-Leasing to finance expenditures related to lease agreements with the Company. The repayment of this loan should be performed in quarterly installments amounting to 1/17th of the funds borrowed and outstanding as at June 1, 2003, starting from August 7, 2003. Interest is accrued at 22%.

25. Related Party Disclosures

Rostelecom

Rostelecom, a majority owned subsidiary of Svyazinvest, is the primary provider of domestic long distance and international telecommunications services in the Russian Federation. The Company has negotiated interconnection agreements with Rostelecom. The annual expense associated with traffic carried by Rostelecom and terminated outside of the Company's network is stated as interconnection charges. Rostelecom uses the Company's network to provide incoming long-distance and international traffic to its subscribers and partner operators. Related amounts included in the accompanying consolidated financial statements as at December 31, 2002 and for the year then ended were as follows:

	2002
Channel rent and traffic charges paid to Rostelecom	1,243,496
Revenue from Rostelecom	19,391
Accounts payable to Rostelecom	134,698

RTC-Leasing

RTC-Leasing is an investee of Rostelecom. Rostelecom exercises control over the management, policies and day-to-day operations of RTC-Leasing.

RTC-Leasing purchases telecommunication equipment from domestic and foreign suppliers and leases the equipment. The Company's obligations under capital leases to RTC-Leasing included in accompanying consolidated balance sheet as at December 31, 2002 may be summarized as follows:

	Minimum payments	**Present value of payments**
Within one year	65,392	32,600
After one year but not more than five years	159,205	99,006
Total minimum lease payments	224,597	
Less amounts representing finance charges	(92,991)	
Present value of minimum lease payments	131,606	131,606

No interest expense on these agreements was accrued in the accompanying consolidated statement of operations for the year ended December 31, 2002 as the equipment was received in the end of December 2002.

The Company issued guarantees for certain loans received by RTC-Leasing from Sberbank (see Note 24, *Commitments and Contingencies*).

25. Related Party Disclosures (continued)

Svyazinvest

The Company regards Svyazinvest as its parent entity. Svyazinvest was wholly owned by the Russian Government until July 1997 when the Government sold 25% plus one share of the charter capital of Svyazinvest to the private sector.

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

The Government's influence is not confined to its share holdings in Svyazinvest. It has general authority to regulate tariffs and does regulate domestic long distance tariffs to a limited extent. In addition, the Ministry of Communications and Informatization of the Russian Federation has control over the licensing of providers of telecommunications services.

As at December 31, 2002, the Company had various loans payable to Svyazinvest outstanding (see Note 19, *Loans and Borrowings*).

In 1998, the Company entered into a joint activity agreement with Svyazinvest (see Note 13, *Interests in Joint Ventures*). A provision for payments to Svyazinvest for cancellation of the agreement in the amount of 37,868 (see Note 22, *Provisions*) was included in the accompanying consolidated balance sheet as at December 31, 2002.

Join Activity with Westelcom

In 1995, the Company entered into a joint activity agreement with Westelcom (see Note 13, *Interests in Joint Ventures*). In 1995-2001 Westelcom was an associated undertaking of Rostelecom, and in 2002 became its subsidiary.

The Company's Investees

The Company concluded several agreements with ZAO "Stavropolskaya Sotovaya Svyaz" ("Stavropol Cellular Network") and ZAO "Stavtelesot" on use the Company's network to provide services to their subscribers. Revenue received by Company from such operations in 2002 amounted to 61,160.

25. Related Party Disclosures (continued)

Kuban GSM

ZAO "Kuban GSM" is a former associated undertaking of the Company (see Note 11, *Investments in Associates*) which provides cellular communication services in Krasnodar region and Republic of Adygeya. In 2002, Kuban GSM remains a related party to the Company, as the General Director of the Company retains a position on the Board of Directors of Kuban GSM. The Company maintains several channel rent and traffic carriage agreements with Kuban GSM. Related income amounting to 131,066 and expenses amounting to 11,931 were included in revenue and interconnect charges, respectively, in the accompanying consolidated statement of operations for the year ended December 31, 2002,

Transactions with State Organisations

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

Government subscribers accounted for approximately 15% of trade accounts receivable as of December 31, 2002. Amounts outstanding from Government subscribers as of December 31, 2002 amounted to 155,868.

Non-Commercial Partnership

Non-commercial partnership "Center for Research of the Problems in Development of Telecommunications" (hereinafter "the Partnership") is a related party to the Company. The Company has an agreement with the Partnership, under which it provides financing for mutually beneficial projects undertaken by the Partnership on behalf of the Company and other subsidiaries and associates of Svyazinvest. Payments to the Partnership included in other operating expenses in the accompanying consolidated statement of operations for the year ended December 31, 2002 amounted to 71,740.

26. Financial Instruments

Fair Values

Management believes that carrying values of the financial instruments included in the accompanying consolidated balance sheet as at December 31, 2002 approximates their fair values.

Interest Rate Risk

The following table sets out, by maturity, the Company’s financial instruments that are exposed to interest rate risk as of December 31, 2002:

	<1 year	1-5 years	>5 years	Total
Fixed rate				
Short-term borrowings	(866,134)			(866,134)
Long-term borrowings	(829,123)	(634,405)	(32,483)	(1,496,011)
Obligations under finance leases	(112,901)	(225,659)		(338,560)
Floating rate				
Loans payable to Vnesheconombank	(797,633)	(271,861)		(1,069,494)

Interest on loans payable to Vnesheconombank is repriced at intervals less than one year.

Interest on financial instruments classified as fixed rate is fixed until maturity of the investment.

27. Subsequent Events

Issue of bonds

On May 29, 2003, the Board of Directors approved the issue of 1,500,000 documentary bearer non-convertible bonds with 1,000 rubles face value each. Bonds have 6 coupons. Interest payments per each coupon are scheduled for every 182th day from the first day of the placement. Interest rate is to be set on tender held on the date of issue. The debentures mature 1,092 days after the placement. As at July 31, 2003, no placement was performed.

Restructuring of debt to Vnesheconombank

On January 30, 2003 the Board of Directors approved restructuring the debt payable to Vnesheconombank in accordance with the Government Decree No. 574 as of July 27, 2002 (with amendments from July 17, 2003). New repayment schedule provides for extension of payments to 2011 and write-off of certain portion of debt if the new schedule is adhered to. Restructuring of debt is subject to further approval by governmental bodies and was not complete as at July 31, 2003.

27. Subsequent Events (continued)

Sale of interest in Stavtelesot

On January 23, 2003 the Company’s subsidiary OAO “Stavtelecom” entered into agreement with OAO “Vympelcom-R”, a major Russian cellular operator, to sell a 41% indirect interest in ZAO “Stavtelesot”, a company providing cellular communications services in Stavropol region of the Russian Federation (see Note 12, *Available-For-Sale Financial Asset*), for USD 17.5 million (approximately 557 million rubles). The sale was completed on January 31, 2003. This interest was acquired in connection with the reorganization described in Note 1, *Corporate Information*, and was reflected as investment held for sale at December 31, 2002. As of July 31, 2003, the Company continues to retain a 10% interest in ZAO “Stavtelesot”.

Extinguishment of Incombank loan

In 2003 the loan payable to Incombank (see Note 19, *Loans and Borrowings*) was purchased by ZAO “Kollidiya”. On July 28, 2003 the Company and ZAO “Kollidiya” have reached preliminary agreement, under which the Company is to pay USD 2.7 million (approximately 81,701) and to transfer rights in its 10% interest in Stavtelesot to ZAO “Kollidiya” in order to fulfill its obligations. As at July 31, 2003 the final agreement has not been reached yet.

Loan agreements with Alfa Bank

On April 28, 2003, the Company concluded an agreement with Alfa Bank to open a non-revolving credit line for the maximum amount of 300 million rubles. The amounts borrowed under this agreement are repayable within 1 year. Interest is accrued at 15.5% per annum. Property, plant and equipment for the amount of approximately 364 million rubles was pledged as a collateral for this agreement. As at July 31, 2003, the amounts borrowed under this agreement totaled 300,000.

On June 20, 2003 the Company concluded an agreement with Alfa Bank to open a non-revolving credit line for the maximum amount of 438,000 rubles. The amounts borrowed under this agreement are repayable within 1 year. Interest is accrued at 14% per annum. Property, plant and equipment for the amount of approximately 511 million rubles was pledged as a collateral for this agreement. As at July 31, 2003, the amounts borrowed under this agreement totaled to 438,000.

On July 25, 2003, the Board of Directors approved a credit agreement with Alfa Bank for the amount of USD 19,070 thousand (approximately 578,883) and related pledge of fixed assets for the amount of approximately 696,360. The interest rate is fixed at 15%. The loan matures in 2007.

27. Subsequent Events (continued)

Loan agreement with Sberbank

On February 28, 2003, the Company concluded an agreement with Sberbank of the Russian Federation (hereinafter Sberbank) to open a non-revolving credit line for the amount of 600 million rubles repayable in installments on various dates from November 23, 2004 untill January 24, 2006. Initially interest rate was determined at 20% per annum, on July 1, 2003 it was reduced to 16% per annum. Property, plant and equipment for the amount of approximately 730 million rubles was pledged as collateral for this agreement. As at July 31, 2003, the amounts borrowed under this agreement totaled to 600,000.

Loan agreement with Promstroybank

On May 16, 2003, the Company concluded an agreement with Promstroybank to open a non-revolving credit line for the amount of 1,000 million rubles. In accordance with the initial terms of the agreement, the loan was repayable on August 18, 2003. Based on the signed addendum to the agreement, the agreement was prolonged till October 14, 2003. Interest is accrued at 12% per annum for the period till August 18, 2003, and at 13% for the period from August 19, 2003 till October 14, 2003. Property, plant and equipment for the amount of approximately 1,065 million rubles was pledged as a collateral for this agreement. As at July 31, 2003, the amounts borrowed under this agreement totaled to 1,000,000.

Implementation of Oracle

On May 28, 2003, the Board of Directors approved an agreement with ZAO Otkritiye Technologii 98 to purchase Oracle E-Business Suite for the amount of USD 21,707 thousand (approximately 689,944).

Purchases of Telecommunications Equipment

On May 19, 2003, the Company concluded several agreements with Technoserv A/S for the total amount of USD 14,890 thousand (approximately 473,270). Under these agreements Technoserv A/S is to deliver and install various telecommunications equipment.

Lease agreements with RTC-Leasing

In 2003 the Company concluded a number of capital lease agreements with RTC-Leasing. Cost of equipment together with installation and other services subject to capitalization acquired under these agreements amounted to approximately 1,756 million rubles, and related undiscounted future lease payments amounted to approximately 3,068 million rubles.

Agreement of Equipment Insurance

On March 28, 2003 the Company concluded an insurance agreement with OOO «Rosgosstrakh-Yug» on insurance of electronic equipment for the period of one year. The total amount of insurance is 5,281,346.

27. Subsequent Events (continued)

Dividends

On June 25, 2003, the annual meeting of shareholders of the Company approved the dividends for the year 2002 in the amount of 0.1607 rubles per one preference share and 0.0812 rubles per one ordinary share. Total dividend announced amounted to 396,619. Dividends for the year ending December 31, 2002 are payable during 2003 and will be recognized in the financial statements as of and for the year ending December 31, 2003. (See also Note 7, *Dividends Paid and Proposed*.)

Tariffs for Telecom Services

Effective July 1, 2003, tariffs for local telephony services were increased by approximately 20%. Tariffs for long-distance calls were decreased.

Telecommunications Reforms

- A new law "On Telecommunications" will come into effect on January 1, 2004.

- Subsequent to December 31, 2002, Rostelecom commenced reforms of the system of settlements with regional operators for domestic long-distance traffic. Under the existing method, settlements between Rostelecom and regional operators are based on one minute of domestic transit traffic sent through 50 km of Rostelecom networks. The integral settlement rate (ISR) contains two components – a linear component and a termination charge, which is calculated based on the weighted average of incoming and outgoing traffic. The ISR was set once a year based on the traffic data for the preceding year and distorted the economic benefits and costs of providing and terminating transit traffic in the year applied.

  Under the planned changes, full consideration is expected to be given to the cost of Rostelecom carrying and benefits to the Company in terminating domestic long-distance traffic. Such system will allow the Company to receive revenues for terminating domestic long-distance traffic based on actual volumes of traffic in the current period, which will increase the transparency and timeliness of settlements.

  As of July 31, 2003 the Company did not sign the new interconnection agreements with Rostelecom.

Management cannot currently predict the outcome of these changes on the Company's future operations.