Open Joint Stock Company
“Southern Telecommunication Company”

Consolidated Financial Statements

Year ended December 31, 2004

with independent auditor’s report

OJSC “Southern Telecommunication Company”

Consolidated Financial Statements

For the year ended December 31, 2004

Contents

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Independent Auditors' Report

To the Shareholders and Board of Directors of OJSC "Southern Telecommunication Company"

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

2. Except as discussed in paragraphs 3 and 4, we conducted our audit in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

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

4. As described in Note 22 "Pension Plan and Employee Benefits", the Company accounted for pension obligations and related expenses. Management did not provide us with sufficient support for the actuarial estimates. We were therefore unable to satisfy ourselves with respect to the pension obligation as of the balance sheet dates, the related expense for the defined benefit pension plan for the years presented, and related disclosures.

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

Ernst & Young Vneshaudit

July 26, 2005

OJSC "Southern Telecommunication Company"

Consolidated Balance Sheet as of December 31, 2004

(in thousand rubles)

	Notes	31-Dec-04	31-Dec-03
ASSETS			
Non-current assets:			
Property, plant and equipment	**5**	**33,553,806**	24,461,457
Intangible assets	**6**	**1,343,609**	583,725
Investments in associates	**8**	**526,876**	409,404
Long-term investments		**27,678**	32,715
Long-term loans given and other assets	**9**	**566,355**	94,253
Long-term advances given	**10**	**475,421**	499,076
Total non-current assets		**36,493,745**	26,080,630
Current assets:			
Inventories	**11**	**1,035,360**	802,996
Accounts receivable	**12**	**1,053,732**	790,636
Short-term investments		**38,049**	5,321
Other current assets	**13**	**1,874,814**	1,844,677
Cash and cash equivalents	**14**	**463,056**	404,113
Total current assets		**4,465,011**	3,847,743
TOTAL ASSETS		**40,958,756**	**29,928,373**
EQUITY AND LIABILITIES			
Shareholders' equity:			
Preference shares	**16**	**751,302**	751,302
Ordinary shares	**16**	**2,287,953**	2,287,953
Retained earnings		**7,598,255**	8,568,685
Total shareholders' equity:		**10,637,510**	11,607,940
Minority interest	**17**	**46,944**	181,909
Non-current liabilities:			
Long-term borrowings	**18**	**11,507,660**	4,968,908
Finance lease obligations	**19**	**2,210,188**	1,710,467
Pension obligations	**22**	**1,009,000**	782,000
Deferred revenue		**390,914**	385,870
Deferred income tax liability	**27**	**587,603**	533,114
Other non-current liabilities		**86,213**	56,199
Total non-current liabilities		**15,791,578**	8,436,558
Current liabilities:			
Accounts payable, advances received and accrued expenses	**20**	**3,731,115**	2,468,773
Payable to Rostelecom	**31**	**134,099**	133,539
Taxes payable	**21**	**584,546**	421,135
Dividends payable		**82,588**	141,289
Short-term borrowings	**18**	**3,816,150**	3,010,603
Current portion of long-term borrowings	**18**	**5,145,301**	2,906,833
Current portion of finance lease obligations	**19**	**988,925**	619,794
Total current liabilities		**14,482,724**	9,701,966
TOTAL EQUITY AND LIABILITIES		**40,958,756**	**29,928,373**

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

OJSC “Southern Telecommunication Company”

Consolidated Statement of Operations

For the year ended December 31, 2004

(in thousand rubles except per share amounts)

	Notes	2004	2003
Revenues	**23**	**17,322,808**	13,948,778
Operating expenses			
Wages, salaries, other employee benefits and payroll taxes		**(6,112,621)**	(5,093,127)
Depreciation and amortization	**5, 6**	**(2,699,167)**	(2,421,009)
Interconnection charges – domestic companies		**(2,495,230)**	(1,872,691)
Materials, repairs and maintenance, utilities		**(2,297,209)**	(1,704,464)
Taxes other than income tax		**(555,113)**	(325,113)
Provision for impairment of receivables	**12**	**(70,141)**	(224,807)
Loss on disposal of property, plant and equipment		**(42,835)**	(52,451)
Other operating expenses	**24**	**(1,544,181)**	(1,501,325)
Total operating expenses		**(15,816,497)**	(13,194,988)
Operating profit		**1,506,311**	**753,790**
Share of result of associates	**8**	**162,297**	96,302
Interest expense, net	**25**	**(2,080,944)**	(638,841)
Bank fees		**(12,826)**	(1,702)
Gain from sale of investments	**26**	**184,346**	377,517
Foreign exchange loss, net		**(57,003)**	(172,557)
(Loss)/profit before income tax		**(297,819)**	**414,509**
Income tax	**27**	**(329,594)**	**(203,101)**
(Loss)/profit for the year		**(627,413)**	**211,408**
Minority interest	**17**	**(39,644)**	**(188,555)**
Net (loss)/profit		**(667,057)**	**22,853**
Basic and diluted (loss)/earnings per share	**16**	(0.17)	0.01

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

OJSC “Southern Telecommunication Company”

Consolidated Statement of Cash Flows

For the year ended December 31, 2004

(in thousand rubles)

	Notes	2004	2003
Cash flows from operating activities:			
(Loss)/profit before income tax and minority interest		**(297,819)**	414,509
Adjustments for:			
Depreciation and amortization	**5, 6**	**2,699,167**	2,421,009
Interest expense, net	**25**	**2,080,944**	638,841
Provision for impairment of receivables	**12**	**70,141**	224,807
Foreign exchange loss, net		**57,003**	172,557
Loss on disposal of property, plant and equipment		**42,835**	52,451
Provision for impairment of inventories		**(9,033)**	(20,392)
Share of result of associates	**8**	**(162,297)**	(96,302)
Gain from other investments	**26**	**(184,346)**	(377,517)
Operating cash flows before working capital changes		**4,296,595**	**3,429,963**
Increase in inventories		**(72,301)**	(124,272)
Increase in accounts receivable		**(337,241)**	(114,457)
Increase in other current assets		**(577,914)**	(1,270,636)
Increase in pension obligations		**227,000**	224,000
Increase/(decrease) in taxes payable		**159,718**	(14,031)
(Decrease)/increase in accounts payable and accrued expenses		**(33,839)**	873,180
Cash flows generated from operations		**3,662,018**	**3,003,747**
Interest paid		**(1,198,946)**	(686,695)
Income tax paid		**(213,415)**	(668,806)
Net cash flows from operating activities		**2,249,657**	**1,648,246**
Cash flows from investing activities:			
Purchase of property, plant and equipment		**(9,289,676)**	(7,659,847)
Purchase of intangible assets		**(225,145)**	(584,837)
(Purchase)/disposal of other financial assets, net		**(21,678)**	–
Purchase of subsidiary		**(27,115)**	–
Proceeds from sales of property, plant and equipment		**41,826**	126,081
Proceeds from sale of subsidiary		**172,506**	–
Proceeds from sale associates		**120,249**	556,706
Interest received		**11,709**	10,452
Dividends received		**44,217**	10,862
Net cash flows used in investing activities		**(9,173,107)**	**(7,540,583)**
Cash flows from financing activities:			
Proceeds from borrowings		**12,961,130**	8,180,330
Repayment of borrowings		**(10,626,639)**	(2,228,585)
Proceeds from promissory notes issues		**2,100,964**	642,005
Repayment of promissory notes		**(959,703)**	(566,188)
Proceeds from debt securities issued		**4,879,490**	1,503,315
Repayment of finance lease obligations		**(530,529)**	(244,900)
Repayment of vendor financing obligations		**(459,919)**	(648,464)
Proceeds from other non-current liabilities		**31,925**	44,384
Dividends paid		**(407,140)**	(460,183)
Dividends paid to minorities in subsidiaries		**(7,186)**	(155,184)
Net cash flows from financing activities		**6,982,393**	**6,066,530**
Net increase in cash and cash equivalents		**58,943**	**174,193**
Cash and cash equivalents at the beginning of the year		**404,113**	229,920
Cash and cash equivalents at the end of the year		**463,056**	404,113

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

OJSC "Southern Telecommunication Company"

Consolidated Statement of Changes in Shareholders' Equity

For the years ended December 31, 2004

(in thousand rubles)

	Notes	Share Capital: Preference shares	Share Capital: Ordinary shares	Retained earnings	Fair Value reserve	Total equity
As of December 31, 2002		751,302	2,287,953	8,942,451	68,468	12,050,174
Net profit for the year		–	–	22,853	–	22,853
Disposal of investment available-for-sale, net of deferred tax		–	–	–	(68,468)	(68,468)
Dividends	**28**	–	–	(396,619)	–	(396,619)
As of December 31, 2003		751,302	2,287,953	8,568,685		11,607,940
Net loss for the year		–	–	(667,057)	–	(667,057)
Purchase of minority interest in subsidiary	**7**	–	–	45,066	–	45,066
Dividends	**28**	–	–	(348,439)	–	(348,439)
As of December 31, 2004		**751,302**	**2,287,953**	**7,598,255**	**–**	**10,637,510**

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

1. General Information

Authorization of Accounts

The consolidated financial statements of OJSC “Southern Telecommunication Company” and its subsidiaries – (hereinafter “the Company”) for the year ended December 31, 2004 were authorized for issue by the General Director and Chief Accountant of the Company on July 26, 2005.

The Company

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

Open joint-stock company Svyazinvest (hereinafter Svyazinvest), a federal holding company controlled by the Russian Federation, owns 50.69% of the Company’s ordinary shares as of December 31, 2004.

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

Information on the Company’s main subsidiaries is disclosed in Note 7. All subsidiaries are incorporated under the laws of the Russian Federation.

The average number of employees in the Company in 2004 was approximately 45 thousand persons (2003 - 44).

The registered office of the Company is in Russia, 350000, Krasnodar, Karasunskaya st., 66.

Tariff Setting

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

The fixed line tariffs are set in Rubles.

Liquidity and Going Concern

In the reporting period the Company obtained short-term and long-term borrowings to finance the development of the communication network. Financing primarily came in the form of bank loans, bonded loans, vendor financing from equipment suppliers and finance leases.

As of December 31, 2004, the Company’s current liabilities exceeded its current assets by 10,017,713 (2003 – 5,854,223). As a result, there may be some doubt about the Company’s ability to pay its existing debts as they fall due.

1. General Information (continued)

Liquidity and Going Concern (continued)

Through 2005, the Company anticipates funding from cash generated from operations and financing from domestic and international lending institutions. Management has also secured sufficient lines of credit to cover the majority of the working capital deficit. This will enable the Company to pay its debts as they fall due in the event the Company does not have sufficient cash on hand. Management also expects to continue to be able to delay payment for certain operating costs to manage its working capital requirements if necessary. Subsequent to the year end the Company has restructured 1 bln. rbl short-term debt into long-term.

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

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

2. Basis of Presentation of the Financial Statements

Basis of Preparation

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

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

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

Management estimates that the carrying value of all of the Company's property, plant and equipment is broadly comparable to their fair values. Management is engaging an independent appraiser to support these fair values and as a result, the reported carrying amount of property, plant and equipment may be adjusted (Note 5). Management has also estimated the defined benefit pension obligation but has engaged an actuary to assess the pension obligation and upon completion of the actuarial valuation the defined benefit obligation may be adjusted (Note 22).

(in thousand rubles)

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

Accounting for the Effect of Inflation

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

Management Estimates

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

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

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

	Shareholders' equity as of December 31, 2003	Net profit/(loss) for the year ended December 31, 2003	Shareholders' equity as of January 1, 2003
Previous GAAP as reported	**11,884,002**	**146,598**	**12,202,491**
Interconnection charges	**111,552**	18,600	92,952
Depreciation (buildings)	**517,888**	25,532	492,356
Revenue accrued	**(19,387)**	(1,760)	(17,627)
Deferred tax	**(104,585)**	57,413	(161,998)
Previous GAAP as restated	**12,389,470**	**246,383**	**12,608,174**
Accrual for defined benefit plan	**(781,530)**	(223,530)	(558,000)
International Financial Reporting Standards	**11,607,940**	**22,853**	**12,050,174**

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

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

3. Summary of Significant Accounting Policies

3.1 Principles of Consolidation

Subsidiaries

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

Minority Interest

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

Acquisition of Subsidiaries’ Minority Interest

IFRS 3 “Business Combinations” applies only to business combinations, such as the acquisition of a subsidiary, whereby the acquirer has obtained control over the business. However, the standard is silent on how later exchange transactions should be accounted for, such as the acquisition of some or all of the minority interest in a subsidiary. The Company does not remeasure the assets and liabilities of the subsidiary to reflect their fair values at the date of the transaction. The difference between the cost of the additional interest in the subsidiary and the minority interest's share of the assets and liabilities is reflected in the consolidated balance sheet at the date of the acquisition of the minority interest as an equity transaction.

3.2 Investments in Associates

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

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

(in thousand rubles)

3. Summary of Significant Accounting Policies (continued)

3.3 Joint control, accounting for joint activities and joint ventures

The Company’s interest in the 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 Company’s consolidated financial statements on a line-by-line basis.

3.4 Investments

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

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

3.5 Foreign Currency Transactions

The measurement and presentation currency of the Company is the Russian Ruble, which is the national currency of the Russian Federation. Transactions in foreign currencies are initially recorded in the measurement currency at the rate ruling at the date of transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the measurement currency rate of exchange ruling at the balance sheet date. All resulting differences are taken to the consolidated statement of operations as foreign exchange gains (losses).

Assets and liabilities settled in Rubles but denominated in foreign currencies are recorded in the Company’s consolidated financial statements using the same principles as for assets and liabilities denominated in foreign currencies.

3.6 Property, Plant and Equipment

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

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

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

3. Summary of Significant Accounting Policies (continued)

3.6 Property, Plant and Equipment (continued)

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

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

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

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

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

Property, plant and equipment transferred to the Company by its customers as payments for installation and connection fees are capitalized at fair value at the date of transfer and a corresponding income is amortize in the income statement during useful life.

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

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

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

3.7 Intangible Assets

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

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

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

3. Summary of Significant Accounting Policies (continued)

3.8 Inventories

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

Cost of inventory is determined on the weighted average basis.

3.9 Accounts Receivable

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

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

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

3.10 Value-Added Tax

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

Value added tax recoverable

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

Value added tax payable

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

3.11 Cash and Cash Equivalents

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

3.12 Borrowings

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

3. Summary of Significant Accounting Policies (continued)

3.13 Leases

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

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

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

3.14 Pensions and Other Post-Employment Benefits

Unified social tax

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

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

Other pension plans and post-employment benefits

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

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

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

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

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

3. Summary of Significant Accounting Policies (continued)

3.14 Pensions and Other Post-Employment Benefits (continued)

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

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

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

3.15 Deferred Income Taxes

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

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

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

3.16 Shareholders’ Equity

Share capital

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

Dividends

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

3. Summary of Significant Accounting Policies (continued)

3.17 Revenue

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

The Company categorizes the revenue sources in the following major categories:

- Long distance telephone calls - domestic;
- Long distance telephone calls - international;
- Local telephone calls;
- Installation and connection fees;
- Documentary services;
- Cellular services;
- Radio and TV broadcasting;
- Data transfer and telematic services;
- New services;
- Rent of telephone channels;
- Services for national operators;
- Other telecommunications services;
- Other revenues;

Long distance calls (domestic and international)

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

Local telephone calls

Revenue from the local telephone services depends on the duration of the telephone connections and subscription fee, while time driven billing scheme is applied. If fixed payment scheme is applied then revenue depends on the subscription fee only.

Customers of the Company use the service via installed landline telephone, as well the service could be accessed by means of pay-phone. The Company recognizes revenues related to the monthly network fees for local services in the month the service is provided to the subscriber.

Installation and connection fees

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

Documentary services

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

3. Summary of Significant Accounting Policies (continued)

3.17 Revenue (continued)

Cellular services

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

Radio and TV broadcasting

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

Data transfer and telematic services

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

New services

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

Rent of telephone channels

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

Services for national operators

Revenue from national service providers includes two different groups.

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

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

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

3. Summary of Significant Accounting Policies (continued)

3.17 Revenue (continued)

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

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

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

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

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

Other telecommunication services

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

Other revenues

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

3.18 Commitments

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

Significant commitments are disclosed.

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

(in thousand rubles)

3. Summary of Significant Accounting Policies (continued)

3.19 Contingencies

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

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

4. Segment Information

Management believes that the Company operates in one industry, i.e. provision of wireline telecommunication services, on the territory of the Southern regions of the Russian Federation. 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.

5. Property, Plant and Equipment

	Land, buildings and constructions	**Switches and transmission devices**	**Construction in progress and equipment for installation**	**Vehicles and other**	**Total**
Cost					
As of December 31, 2003	10,216,605	10,667,016	3,634,022	1,722,878	26,240,521
Additions	-	-	12,061,223	-	12,061,223
Disposals	(75,039)	(368,646)	(9,206)	(90,220)	(543,111)
Disposals due to sale of subsidiary	(86,358)	(71,645)	(58,634)	(13,096)	(229,733)
Transfers	5,808,880	3,815,588	(10,631,662)	1,007,194	-
At December 31, 2004	**15,864,088**	**14,042,313**	**4,995,743**	**2,626,756**	**37,528,900**
Accumulated depreciation					
As of December 31, 2003	(432,824)	(1,068,189)	-	(278,051)	(1,779,064)
Charge for the year	(717,198)	(1,670,488)	-	(302,606)	(2,690,292)
Disposals	66,372	319,252	-	72,827	458,451
Disposals due to sale of subsidiary	12,475	14,543	-	8,793	35,811
At December 31, 2004	**(1,071,175)**	**(2,404,882)**	**-**	**(499,037)**	**(3,975,094)**
Net book value at December 31, 2003	9,783,781	9,598,827	3,634,022	1,444,827	24,461,457
Net book value at December 31, 2004	**14,792,913**	**11,637,431**	**4,995,743**	**2,127,719**	**33,553,806**

As of December 31, 2004 construction in progress and equipment for installation included cable and construction materials in the amount of 68,515 (December 31, 2003 – 195,297).

(in thousand rubles)

5. Property, Plant and Equipment (continued)

The Company has applied an exemption permitted by IFRS 1 which allows an entity to measure property, plant and equipment at the date of transition to IFRS at fair value and use that fair value as deemed cost. Management estimates that the carrying value of all of the Company's property, plant and equipment is broadly comparable to its fair value but is intending to engage an independent appraiser to support these fair values.

The net book value of plant and equipment held under finance leases at December 31, 2004 is 3,964,984 (2003 - 2,778,434). Leased assets are pledged as security for the related finance lease obligations (Note 19).

In 2004 the Company increased construction in progress by the amount of capitalized interest totaling 579,106 (2003 - 92,082). Capitalization rate in 2004 was 14.9%.

At December 31, 2004 bank borrowings are secured by properties to the value of 6,191,869 (2003 – 3,551,212) (Note 18).

6. Intangible Assets

	Licenses	Software	Other	Total
Cost				
As of December 31, 2003	5,177	590,080	2,148	597,405
Additions	723	768,036	–	768,759
As of December 31, 2004	5,900	1,358,116	2,148	1,366,164
Accumulated amortization				
As of December 31, 2003	(3,359)	(9,419)	(902)	(13,680)
Charge for the year	(1,500)	(6,996)	(379)	(8,875)
As of December 31, 2004	(4,859)	(16,415)	(1,281)	(22,555)
Net book value as of December 31, 2003	1,818	580,661	1,246	583,725
Net book value as of December 31, 2004	**1,041**	**1,341,701**	**867**	**1,343,609**

The majority of licenses are amortized over 5 years period.

Oracle E-Business Suite

As of December 31, 2004 software includes Oracle E-business Suite software with a net book value of 718,759 (2003 - 565,116), including capitalized interest of 104,796 (2003 - 19,820). In accordance with the supply contract, the Company has been provided with non-exclusive licenses for 10,745 users of E-business Suite 2003 Professional among other license applications.

The Company shall amortize the value of this software starting from the date of its implementation over useful life of the licenses. Until then the Company shall annually test this software for impairment.

Full implementation of Oracle E-Business Suite software is expected in 2008.

Advances given to install Oracle E-Business Suite software in the amount of 96,327 (2003 – 5,273) are included in "Long-term advances given" (see Note 10).

(in thousand rubles)

6. Intangible Assets (continued)

Amdocs Billing Suite

As of December 31, 2004 software also includes Amdocs Billing Suite software with net book value of 527,487 (2003 – nil). This software was purchased for the purpose of implementation of unified automated settlements system. The project of implementation of the unified automated settlements system is expected to last 4-5 years.

The Company's Board of Directors approved purchase of Amdocs Billing Suite software on November 22, 2004.

Amdocs Billing Suite software was supplied in December 2004 by OOO "IBM Eastern Europe/Asia", at which point the Company transferred its ordinary promissory notes with face value of 648,810. Full repayment of promissory notes issued is expected to be exercised by June 1, 2006.

The Company shall start amortizing this asset starting from the date of software implementation proportionally to the cost of implemented modules. Until then the Company shall annually test this software for impairment.

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

7. Investments in Subsidiaries and Joint Venture

The consolidated financial statements include the assets, liabilities and financial results of the Company and its subsidiaries listed below:

		Equity interest/Voting Stock	
Subsidiary	**Main Activity**	**2004**	**2003**
CJSC "Armavirskiy Zavod Svyazi"	Cable production	**100%**	100%
OJSC "Orbita" Recreational House"	Recreational services	**100%**	100%
CJSC "CMTO"	Supply of materials	**100%**	100%
CJSC "Yugsvyazstroy"	Construction services	**100%**	100%
LLC "Intmashservice"	Communication facilities repairs and support	**100%**	100%
LLC "Faktorial-99"	Informational and commercial agency activity	**100%**	100%
LLC "YuTC-Finance"	Financial Service	**100%**	100%
OJSC "Stavtelecom named after V.I.Kuzminov" (OJSC "Stavtelecom")	Local, intercity communications, data transfer	**81%**	51%
CJSC "Telesot-Alaniya"	Cellular telecommunication services (GSM-900)	**–**	53%
CJSC "Avtotsenter-Yug"	Transport	**–**	100%

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

(in thousand rubles)

7. Investments in Subsidiaries and Joint Venture (continued)

In 2004 in accordance with the decisions of the Company's Board of Directors the Company increased its share in OJSC "Stavtelecom", the fixed line operator in Stavropol region, up to 81%. The difference between the cost of the additional interest in the subsidiary and the minority interest's share of the assets and liabilities amounted to 45,066 was reflected in the consolidated retained earnings as of December 31, 2004.

In 2004 in accordance with the decisions of the Company's Board of Directors the Company sold its share in CJSC "Telesot-Alaniya" for 172,506. The related gain from sale of CJSC "Telesot-Alaniya" amounted 52,904 (Note 26).

CJSC "Avtotsenter-Yug" was liquidated in the first quarter 2004 and the Company received the assets from the liquidation in the amount of 7,248 in carrying value.

Joint Venture with ZAO "Westelcom"

The Company owns 50% of the stock of the joint venture with ZAO "Westelcom" to build and operate digital communications networks in the Republic of Adygeya. The joint venture agreement was executed in November 1995 for the term of 10 years with possible prolongation. The Company's share of the assets, liabilities, revenue and expenses of the joint venture are included in the consolidated financial statements under proportionate consolidation method.

8. Investments in Associates

Investments in associates at December 31, 2004 and 2003 include:

		As of December 31, 2004		**As of December 31, 2003**	
Associate	**Main activity**	**Voting shares**	**Carrying value**	**Voting shares**	**Carrying value**
CJSC "Volgograd GSM"	Cellular services (GSM)	**50%**	**462,036**	50%	360,302
LLC "Yug-Giprosvyaz"	Project engineering	**24%**	**26,239**	24%	–
OJSC "TeleRoss-Kubanelektrosvyaz"	Telecommunication services	**50%**	**15,309**	50%	11,968
CJSC "Stavropol cellular communications"	Cellular services (AMPS-800 MHz)	**50%**	**13,156**	50%	15,696
CJSC "Karachayevo-CherkesskTeleSot"	Cellular communications, GSM-900 MHz	**20%**	**6,095**	20%	1,633
CJSC "TeleRoss-Volgograd"	Local and intercity communication services	**50%**	**3,851**	50%	3,314
OJSC "Stavropolskoe commercheskoe televidenie"	Creation and development of paid broadcast TV	**45%**	**162**	45%	394
CJSC "ZanElCom"	Support of regional network IT systems	**45%**	**28**	45%	26
CJSC "IR Telekinocompaniya"	Commercial TV and radio broadcasting services	**24%**	**–**	24%	–
CJSC "Kabardino-Balkar GSM"	Cellular communications, GSM-900 MHz	**20%**	**–**	20%	–
CJSC "Volgograd-Mobile"	Cellular services (AMPS - 800 MHz)	**–**	**–**	50%	15,821
CJSC "Cellular communications - Alaniya"	Cellular services, NMT-450 MHz	**–**	**–**	30%	250
CJSC "Astrakhan-Mobile"	Cellular services (AMPS-800MHz)	**–**	**–**	50%	–
Total			**526,876**		**409,404**

(in thousand rubles)

8. Investments in Associates (continued)

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

CJSC "IR Telekinocompaniya" reported accumulated losses in the amount of 598 and 198 as of December 31, 2004 and December 31, 2003, respectively. CJSC "Kabardino-Balkar GSM" reported accumulated losses in the amount of 883 and 923 as of December 31, 2004 and December 31, 2003, respectively. As the Company's share in accumulated losses of this associate exceeded the interest in the associate, the Company did not recognize further losses.

In 2004 in accordance with the decisions of the Company's Board of Directors the Company sold its shares in the following associate companies:

Name	Sale price	Carrying value as of the sale/disposal	Sale of share in equity on the date of transaction, %
CJSC "Volgograd-Mobile"	84,738	–	50%
CJSC "Astrakhan- Mobile"	32,142	–	50%
CJSC "Cellular communications - Alaniya"	8,769	–	30%
Total	**125,649**	**–**	

The carrying amount of the associate as of the date of disposal was equal to zero. The gain from the sale of associate companies is disclosed in the Note 26. The equity loss recognized until the date of disposal of these associates amounted to 16,071. Selling expenses related to the sale of associate companies amounted to 5,400.

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

	2004	2003
Investments in associates as of January 1	**409,404**	323,964
Share of income, net of income tax	**162,297**	96,302
Dividends accrued	**(44,825)**	(10,862)
Investments in associates as of December 31	**526,876**	**409,404**

9. Long-Term Loans Given and Other Assets

As of December 31, 2004 and 2003, long-term loans given and other assets included:

	2004	2003
VAT recoverable	**436,585**	31,891
Constructed assets held for sale	**83,291**	41,830
Deferred bank charges	**25,653**	–
Long-term loans given to employees	**18,646**	16,853
Long-term loans given to legal entities	**2,180**	3,679
Total	**566,355**	**94,253**

(in thousand rubles)

10. Long-Term Advances Given

As of December 31, 2004 and 2003 advances given to suppliers for non-current assets, comprised the following:

	2004	2003
Advances given for capital constructions	**379,094**	493,803
Acquisition of Oracle E-Business Suite software (Note 6)	**96,327**	5,273
Total	**475,421**	**499,076**

11. Inventories

Inventories as of December 31, 2004 and 2003 included the following:

	2004	2003
Cable, materials, fuel and spare parts for telecommunications equipment	**842,325**	644,957
Finished goods and goods for resale	**98,864**	73,619
Small tools and other inventories	**94,171**	84,420
Total	**1,035,360**	**802,996**

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

12. Accounts Receivable

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

	2004	2003
Trade receivables – telecommunication services	**1,476,266**	1,131,355
Trade receivables – other	**51,704**	78,439
Provision for impairment of receivables	**(474,238)**	(419,158)
Total	**1,053,732**	**790,636**

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

	2004	2003
Corporate customers	**231,126**	250,783
Residential customers	**483,220**	469,893
Tariff compensation from the state budget	**627,533**	287,571
Governmental customers	**134,387**	123,108
Total	**1,476,266**	**1,131,355**

Prior to January 2005, telecommunication services provided to privileged customers, which are individuals that the government has agreed to provide certain benefits, was compensated 50% by the state budget and the other 50% paid by the privilege subscribers themselves. Article 47 of the Federal Law “On Telecommunications” No. 126-FZ dated July 7, 2003 is effective starting from 2005, which amends the rules on providing telecommunication services to privileges customers. Starting from January 2005 telecommunication customers with the right of privileges are obliged to pay for telecommunication services in full with the subsequent reimbursement of their expenses by the state budget.

(in thousand rubles)

12. Accounts Receivable (continued)

The state budget is still responsible to compensate the amounts due from privileged customers at December 31, 2004 in the amount of 627,533. The Company has made an assessment of the recoverability of these amounts and has accrued a provision for impairment of receivables of 336,347. The whole amount of the receivables from privileged customers at December 31, 2003 of 287,571 was under provision due to low expectation for timely recovery.

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

	2004	**2003**
Balance as of January 1	**419,158**	198,411
Provision for the year	**70,141**	224,807
Trade and other receivables write-off	**(15,061)**	(4,060)
Balance as of December 31	**474,238**	**419,158**

13. Other Current Assets

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

	2004	**2003**
VAT recoverable	**1,244,656**	1,269,956
Prepayments and advances	**432,941**	356,596
Prepaid income tax	**112,175**	158,454
Other prepaid taxes	**14,253**	31,144
Short-term loans given to legal entities	**13,950**	–
Other receivables and current assets	**56,839**	28,527
Total	**1,874,814**	**1,844,677**

14. Cash and Cash Equivalents

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

	2004	**2003**
Cash at bank and on hand	**461,969**	403,412
Other cash equivalents	**1,087**	701
Total	**463,056**	404,113

As of December 31, 2004 cash at bank and on hand includes 455 (2003 - 558) denominated in foreign currency.

15. Significant Non-Cash Transactions

In 2004 the Company had the following non-cash transactions:

- revenue from services provided settled by an exchange of services in amount of 1,589,261 (2003 – 860,061);
- purchase of telecommunication equipment purchased under leasing agreements in the amount of 1,399,382 (2003 – 2,236,601);
- revenue from installation and connection services provided settled by an exchange of equipment in the amount of 44,622 (2003 – 51,497);
- purchase of property, plant and equipment under suppliers credit in the amount of 1,876,115 (2003 – 608,910);
- purchase of Amdocs Billing Suite for 648,810 and paid for by the promissory notes (Note 6).

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

(in thousand rubles)

16. Share Capital

As at December 31, 2004 and 2003 the authorized number of ordinary and preference shares were 2,960,512,964 and 972,151,838 respectively. All authorized shares have been issued and fully paid.

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

Type of share	Number of outstanding shares	Par value per one share/Ruble	Total par value	Carrying value
Ordinary	2,960,512,964	0.33	**976,969**	2,287,953
Preference	972,151,838	0.33	**320,810**	751,302
Total			**1,297,779**	**3,039,255**

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

All authorised shares have been issued and fully paid.

The ordinary shareholders, which represent 75% of the share capital, are entitled to one vote per share. Class A preference shares, which represent 25% of the share capital, give the holders the right to participate in general shareholders’ meetings without voting rights except in instances where decisions are made in relation to reorganization and liquidation of the Company, and where changes and amendments to the Company’s charter which restrict the rights of preference shareholders are proposed. The preference shares have no rights of redemption or conversion but carry non-cumulative dividends of 10% of Russian accounting net income for the year. Annual amount of dividends on class A preference shares may not be less than dividends on ordinary shares. As such, the preference shareholders share in earnings along with ordinary shareholders and thus the preference shares are considered participating shares for the purpose of the calculation of earnings per share. If the Company fails to pay dividends, or has no profits in any year, the preferred shareholders have the right to vote in the general shareholders’ meeting.

In April 22, 2002 the Company executed a depositary agreement with JP Morgan Chase Bank regarding placement of American Depositary Receipts (ADRs), Level 1. The depositary agreement between the Company and JP Morgan Chase Bank was revised on December 15, 2002 in accordance with the reorganization. In accordance with the depositary agreement each ADR is equal to 50 ordinary shares of the Company. 1,581,380 ADRs represented 79,069,000 deposited ordinary shares, which constituted 2.67% of total ordinary shares issued as of December 31, 2004.

Dividends were declared in 2004 in respect of 2003 to holders of ordinary shares and preference shares of 0.0812 Ruble per ordinary share (2003 –0.0812 Ruble per ordinary share) and 0.1111 Ruble per preference share (2003 –0.1607 Ruble per preference share).

In accordance with the Russian legislation, dividends may only be declared to the shareholders of the Company from net income as shown in the Company's Russian statutory financial statements. The Company reported net income 276,649 and 1,080,437 in its statutory financial statements in 2004 and 2003, respectively.

16. Share Capital (continued)

The Company’s shareholding structure as of December 31, 2004 (in thousands of shares) was as follows:

	Ordinary shares		**Preference shares**		
	Number of shares	**%**	**Number of shares**	**%**	**Total**
OJSC Svyazinvest	1,500,671	50,69	–	–	1,500,671
Other legal entities	1,115,161	37,67	717,718	73,83	1,832,879
Individuals	344,681	11,64	254,434	26,17	599,115
Total	**2,960,513**	**100**	**972,152**	**100**	**3,932,665**

(Loss)/earnings per Share

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

	2004	**2003**
Weighted average number of preference shares outstanding (thousands)	**972,152**	972,152
Weighted average number of ordinary shares outstanding (thousands)	**2,960,513**	2,960,513
Weighted average number of ordinary and preference shares outstanding (thousands)	**3,932,665**	3,932,665
Net (loss)/income	**(667,057)**	**22,853**
(Loss)/earnings per share (basic/diluted)	**(0.17)**	**0.01**

There are no dilutive instruments, therefore basic (loss)/earnings per share is equal to diluted (loss)/earnings per share.

17. Minority Interest

Movement of minority interest for the years ended December 31, 2004 and 2003 is as follows:

	2004	**2003**
Minority interest as of January 1	**181,909**	148,539
Minority interest in net assets of acquired subsidiary (OJSC "Stavtelecom”)	**(72,956)**	–
Minority interest in net income of subsidiaries	**39,644**	188,555
Minority interest in subsidiary sold (CJSC “Telesot-Alaniya”)	**(95,241)**	–
Dividends paid to minority shareholders of subsidiaries	**(6,412)**	(155,185)
Minority interest as of December 31	**46,944**	**181,909**

(in thousand rubles)

18. Borrowings

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

	Range of interest rate	Maturity date	2004	2003
Short-term borrowings				
Bank loans (Rubles)	10% - 19%	2005	**751,298**	2,321,402
Vendor financing (US Dollars)	6.7% - 8%	2005	**14,058**	–
Vendor financing (Euro)	4% - 8.5%	2005	**237,427**	–
Promissory notes (Rubles)	13% - 15.7%	2005	**1,976,771**	187,100
Interest payable			**836,596**	502,101
Total short-term borrowings			**3,816,150**	**3,010,603**
Long-term borrowings				
Bank loans (Rubles)	11.6% - 20%	2005-2008	**8,550,489**	4,920,746
Bank loans (US Dollars)	14.50%	2004	**–**	54,847
Total bank loans			**8,550,489**	4,975,593
Bonds (Rubles)	12.3% - 14.24%	2006-2009	**6,440,351**	1,500,000
Vendor financing (Euro)	6% - 8.5%	2005-2006	**932,924**	1,056,559
Vendor financing (US Dollars)	6% - 8%	2005-2006	**50,971**	226,186
Vendor financing (Japanese Yen)	7.56%	2005-2006	**20,689**	51,653
Total vendor financing			**1,004,584**	1,334,398
Promissory notes (US Dollars)	6%	2005-2006	**605,475**	–
Other borrowings (US Dollars)	14% - 21%	2005-2009	**52,062**	65,750
Total long-term borrowings			**16,652,961**	**7,875,741**
Less: Current portion of long-term borrowings		2005	**(5,145,301)**	**(2,906,833)**
Total long-term borrowings, net of current portion			**11,507,660**	**4,968,908**

As of December 31, 2004 bank loans are secured by property, plant and equipment with the carrying value of 6,191,869 (2003 – 3,551,212).

(in thousand rubles)

18. Borrowings (continued)

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

Maturity date	Bank loans	Bonds	Vendor financing	Promissory Notes	Other	Total
2005	2,304,847	1,492,816	956,491	386,181	4,966	**5,145,301**
2006	3,045,642	1,500,000	42,305	219,294	1,656	**4,808,897**
2007	2,600,000	–	5,788		1,672	**2,607,460**
2008	600,000	–	–		1,613	**601,613**
2009	–	3,447,536	–		3,666	**3,451,202**
After 2009	–	–	–		38,488	**38,488**
Total	**8,550,489**	**6,440,352**	**1,004,584**	**605,475**	**52,061**	**16,652,961**

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

	2004	2003
Russian Rubles	**18,317,931**	9,055,859
Euro	**1,459,987**	1,497,799
US dollars	**670,504**	281,033
Japanese yen	**20,689**	51,653
Total	**20,469,111**	**10,886,344**

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

<u>Bonds</u>

On September 18, 2003 the Company issued 1,500 thousand non-convertible interest-bearing bearer's bonds, Series 01, par value of 1,000 Rubles each. The bonds mature in three years from the date of issue (September 2006) and provides semiannual coupons. The coupon interest rate is 14.24% per annum.

On February 11, 2004 the Company issued 1,500 thousand non-convertible interest-bearing bearer's bonds, Series 02, par value of 1,000 Rubles each. The bonds mature in three years from the date of issue (February 2007) and provides semiannual coupons. The interest rate of the first and second coupons is 9.25% annually, of the third and forth coupons is 12%. The Board of Directors will establish the interest rate for the third year for the bonds. The bond issue has two options of earlier redemption at par value - in February 2005 and February 2006. Accordingly, these bonds have been included in current portion of long-term liabilities. In February 2005 bondholders exercised the right of earlier redemption (Note 33).

On October 6, 2004 the Company issued 3,500 thousand non-convertible interest-bearing bearer's bonds, Series 03, par value of 1,000 Rubles each. The bonds mature in five years from the date of issue (October 2009) and provides semiannual coupons. The bond issue has two options of earlier redemption at par value - in April, 2006 and October, 2007. The coupon interest rate for the first three coupons was determined at 12.3%. The other coupon rates will be determined ten days before the coupon payment days.

Funds received from bonds issuance are used for current and investment Company's activities and for short-term liabilities substitution.

(in thousand rubles)

18. Borrowings (continued)

Vendor Financing

Long-term vendor financing outstanding as of December 31, 2004 was as follows:

Vendor	Currency	Maturity	Contractual interest rate	Amount outstanding
Vnesheconombank	Euro	2005	6.5%	**816,270**
OJSC Alfa-Bank	Euro	2006-2007	5.95%	**73,625**
LLC "CNT"	US Dollars	2005	6.7%	**44,467**
Lucent Technologies	Euro	2005-2006	7.17%	**32,006**
Nec Neva Communication Systems	Japanese Yen	2005-2006	7.17%	**20,690**
LLC Mashpriborcom	Euro	2005	4%	**11,022**
CJSC "IskraUralTel"	US Dollars	2005-2007	8%	**6,504**
Total				**1,004,584**

Short-term and Long-term Promissory Notes

In 2003 and 2004 the Company executed promissory notes sales and purchase agreements with CJSC "RTC-Invest". As of December 31, 2004 the Company had an outstanding amount of 954,819 (2003 - 64,746). Interest is charged at the rate of 14-15% per annum.

In July 2004 the Company executed a promissory notes sales and purchase agreement with "Vneshtorgbank". The notes are to be redeemed in 2005. As of December 31, 2004 the Company had an outstanding liability in the amount of 718,000. Interest is charged at the rate of 13% per annum.

In December 2004 the Company issued non interest bearing notes transferred to OOO "IBM Eastern Europe/Asia" at disounted amount of 605,475 (with face value of 648,810). The current portion to be repaid in 2005 amounted to 219,294. Full repayment of the notes issued is expected to be exercised by June 1, 2006.

Other promissory notes have been issued in the amount of 303,952 and bear interest between 13% and 15.7%.

19. Finance Lease Obligations

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

	2004		**2003**	
	Minimum lease payments	**Present value of payments**	**Minimum lease payments**	**Present value of payments**
Current portion	**1,506,229**	**988,925**	1,089,268	619,794
2 to 5 years	**2,943,620**	**2,210,188**	2,492,100	1,710,467
Total minimum lease payments	**4,449,849**	**3,199,113**	**3,581,368**	**2,330,261**
Less amounts representing finance charges	**(1,250,736)**	**–**	(1,251,107)	–
Present value of minimum lease payments	**3,199,113**	**3,199,113**	**2,330,261**	**2,330,261**

(in thousand rubles)

19. Finance Lease Obligations (continued)

In 2004 and 2003, the Company's primary lessor was OJSC “RTC-Leasing”. In 2004, effective interest rate on leasing liabilities ranged from 17% to 24% per annum (2003 - from 24% to 31%).

OJSC “RTC-Leasing” purchases telecommunication equipment from domestic and foreign suppliers and leases the equipment. The Company’s obligations under capital leases to OJSC “RTC-Leasing” as of December 31, 2004 comprised 4,354,613 (2003 - 3,365,606) including 3,113,955 principal amount (2003 - 2,159,321) and 1,240,658 interest payable (2003 -1,206,285).

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

As of December 31, 2004 finance lease obligations denominated in foreign currency, mainly Euro, amounted to 95,160 (2003 - 213,626).

20. Accounts Payable, Advances Received and Accrued Expenses

As of December 31, 2004 and 2003, the Company’s accounts payable, advances received and accrued expenses comprised the following:

	2004	2003
Accounts payable for to equipment suppliers and contractors	**2,355,249**	1,038,817
Salaries and wages	**415,472**	366,203
Advances received from subscribers	**351,668**	388,060
Trade accounts payable	**560,558**	570,074
Other accounts payable	**48,168**	105,619
Total	**3,731,115**	**2,468,773**

As of December 31, 2004 and 2003 62,431 and 288,430 of trade payables are denominated in foreign currency, mainly US Dollars and Euro.

Other accounts payable include outstanding settlements with suppliers and contractors in relation to investment activities, voluntary property insurance, voluntary payments to labor unions and payments to Non-Commercial Partnership (Note 31).

21. Taxes Payable

Current taxes payable

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

	2004	2003
Value added tax	**200,114**	164,745
Property tax	**158,137**	39,927
Unified social tax	**119,250**	98,978
Income tax	**69,157**	9,812
Individual income tax	**27,189**	23,722
Sales tax	**101**	30,746
Other taxes	**10,598**	53,205
Total	**584,546**	**421,135**

Payment of value added tax of 130,005 (2003 - 138,804) is conditional upon collection or write-off of the respective trade accounts receivable.

(in thousand rubles)

22. Pension Obligations

In addition to statutory pension benefits, the Company also contributes to post-employment benefit plans, which covers most of its employees. The Company has applied the exemption permitted by IFRS 1 which allows an entity to recognize all cumulative actuarial gains and losses at the date of transition even if the corridor approach is used for latter actuarial gains and losses. Management has estimated the defined benefit pension obligation but has engaged an actuary to assess the pension obligation and upon completion of the actuarial valuation the defined benefit obligation may be adjusted.

Defined benefit pension plans

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

Non-government pension fund “Telecom-Soyuz”, which is related to the Company (Note 31), maintains the defined benefit pension plan. The Company makes contributions to the pension fund in the amount set forth in the agreement with the pension fund.

Additionally the Company provides financial support, of a defined benefit nature, to some of its former employees.

As of December there were 40,432 active participants to the defined benefit pension plan of the Company and 2,586 pensioners eligible to the post-employment and post-retirement benefits (as of December 31, 2003 – 41,885 and 2,081 respectively).

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

	2004	**2003**
Present value of defined benefit obligation	**1,832,000**	1,724,000
Fair value of plan assets	**(197,000)**	(146,000)
Present value of unfunded obligations	**1,635,000**	1,578,000
Unrecognised actuarial (losses)/gains	**(104,000)**	123,000
Unrecognised past service cost	**(522,000)**	(919,000)
Net pension liability in the balance sheet	**1,009,000**	**782,000**

As of December 31, 2004 management estimated employees’ average remaining working life at 10 years (2003 - 10 years).

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

	2004	**2003**
Service cost	**55,000**	65,000
Interest cost	**161,000**	143,000
Expected return on plan assets	**(16,000)**	(10,000)
Amortisation of past service cost – non-guaranteed portion	**112,000**	98,000
Net expense for the defined benefit pension plan	**312,000**	**296,000**

(in thousand rubles)

22. Pension Obligations (continued)

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

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

	2004	**2003**
Net liability at January 1	**782,000**	558,000
Net expense for the year	**312,000**	296,000
Contributions	**(85,000)**	(72,000)
Net liability at December 31	**1,009,000**	**782,000**

As of December 31, 2004 and 2003 the principle actuarial assumptions of defined benefit pension plans were as follows:

	2004	**2003**
Discount rate	**9.18% p.a.**	9.18% p.a.
Expected return on plan assets	**9.33% p.a.**	9.26% p.a.
Future salary increases	**9.18% p.a.**	9.18% p.a.
Relative pay increase (career progression)	**1% p.a.**	1% p.a.
Rate used for calculation of annuity value	**6% p.a.**	6% p.a.
Increase in financial support benefits	**6% p.a.**	6% p.a.
Staff turnover	**5% p.a.**	5% p.a.
Mortality tables (source of information)	**Russian population 1998**	Russian population 1998

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

	2004	**2003**
Fair value of plan assets at January 1	**146,000**	83,000
Actual return on plan assets	**8,000**	16,000
Employer contributions	**85,000**	72,000
Benefits paid	**(42,000)**	(25,000)
Fair value of plan assets at December 31	**197,000**	**146,000**

Actual return on plan assets for 2004 was 4.78%.

(in thousand rubles)

23. Revenues

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

By revenue types	**2004**	**2003**
Long distance telephone services - national	**5,894,025**	5,048,312
Local telephone calls	**4,786,789**	3,740,857
Installation and connection fees	**1,423,746**	1,348,992
Long distance telephone services - international	**1,095,773**	1,003,212
Services for national operators	**876,924**	495,730
New services	**803,421**	514,323
Rent of telephone channels	**624,930**	359,581
Other telecommunications services	**394,872**	425,720
Cellular services	**209,224**	167,148
Radio and TV broadcasting	**192,045**	187,858
Data transfer and telematic services	**170,750**	200,913
Documentary services	**70,515**	39,151
Sale of cable production	**185,359**	40,126
Construction services	**193,463**	38,204
Sale of goods	**124,461**	99,842
Recreational services	**106,382**	69,736
Revenue from rent of assets	**93,635**	78,623
Agency fees	**21,613**	25,267
Other non-telecom revenues	**54,881**	65,183
Total	**17,322,808**	**13,948,778**

The Company identifies revenue by the following major customer groups:

Customer groups	**2004**	**2003**
Residential customers	**9,172,786**	7,621,726
Corporate customers	**5,974,804**	4,696,663
Government customers	**1,304,428**	1,056,236
Privilege customers, compensated from state budget	**870,790**	574,153
Total	**17,322,808**	**13,948,778**

Privileged customers are individuals that the government had agreed to provide certain benefits, including reduced cost for telecommunication services. The government was obliged to compensate the Company 50% of charged tariffs from the state budget (Note 12).

(in thousand rubles)

24. Other Operating Expenses

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

	2004	2003
Security and fire protection services	**246,840**	167,375
Insurance of property, plant and equipment	**223,907**	135,949
Cost of goods sold	**152,981**	167,939
Rent of premises	**131,106**	107,582
Charitable contributions	**83,158**	74,211
Professional services	**77,055**	57,045
Advertising expenses	**69,927**	59,321
Business travel expenses and representation costs	**64,731**	60,955
Charges for undue payments	**62,599**	55,723
Transportation services	**54,463**	46,359
Telecommunication regulatory fees	**49,094**	39,880
Payments to Non-Commercial Partnership (Note 31)	**–**	135,162
Commission paid to retail outlets	**43,115**	13,885
Training expenses	**38,926**	36,459
Charges due settlements with non-payers	**35,451**	40,388
Payments to professional unions, cultural events expenses	**23,653**	18,123
Post services	**7,797**	7,785
Other expenses	**179,378**	277,184
Total	**1,544,181**	**1,501,325**

25. Interest Expense, net

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

	2004	2003
Interest expense	**1,581,147**	482,157
Interest expense accrued on financial leases	**511,506**	167,136
Interest income	**(11,709)**	(10,452)
Total	**2,080,944**	**638,841**

26. Gain from Sale of Investments

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

	2004	2003
Gain from sale of share in subsidiary	**52,904**	–
Gain from sale of share in associates	**120,249**	369,000
Gain from sale of other investments	**9,087**	5,622
Dividend income	**2,106**	2,895
Total	**184,346**	**377,517**

(in thousand rubles)

27. Income Tax

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

	2004	2003
Current income tax expense	**(272,760)**	(630,799)
Deferred income tax (expense)/benefit	**(56,834)**	427,698
Total income tax expense	**(329,594)**	**(203,101)**

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

	2004	2003
(Loss)/profit before income tax and minority interest	**(336,297)**	414,508
Statutory income tax rate	**24%**	24%
Theoretical tax charge at statutory income tax rate	**(80,711)**	99,482
Increase (decrease) resulting from the effect of:		
Non-taxable income	**73,091**	53,288
Expenses not deductible for tax purposes	**(321,974)**	(355,871)
Total income tax charge for the year at the effective rate of - %(2003 - 49%)	**(329,594)**	**(203,101)**

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

	2004	2003
Tax effects of deferred tax assets:		
Deferred revenues	**114,079**	99,979
Provision for impairment of receivable	**89,632**	75,500
Accounts payable and accrued expenses	**37,602**	29,208
Inventory	**1,563**	4,050
Deferred tax asset, total	**242,876**	**208,737**
Tax effects of deferred tax liabilities:		
Property, plant and equipment	**(562,966)**	(585,721)
Financial leasing liabilities	**(122,533)**	(71,300)
Other current assets	**(80,921)**	(46,607)
Investment in associates	**(35,304)**	(30,375)
Intangible assets	**(28,755)**	(7,848)
Deferred income tax liability, total	**(830,479)**	**(741,851)**
Total net deferred income tax liability	**(587,603)**	**(533,114)**

The movement in net deferred tax liability for the years ended December 31, 2004 and 2003 is presented below:

	2004	2003
Net deferred tax liability at January 1	**(533,114)**	**(982,433)**
Deferred tax (expense)/benefit	**(56,834)**	427,698
Deferred tax related to subsidiary disposal	**2,345**	–
Deferred tax expenses due to change of fair value of investments available for sale	**–**	21,621
Net deferred tax liability at December 31	**(587,603)**	**(533,114)**

(in thousand rubles)

28. Dividends Declared and Proposed for Distribution

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

Dividends declared and approved during the year:

	2004	2003
Dividends on ordinary shares, 0.0812 Rubles per share (2003 – 0.0812 Rubles per share)	**240,394**	240,394
Dividends on preference shares, 0.1111 Rubles per share (2003 – 0.1607 Rubles per share)	**108,045**	156,225
Total	**348,439**	**396,619**

Dividends declared and approved subsequent to the year end (Note 33)

Dividends on ordinary shares, 0.0093 Rubles per share	27,650
Dividends on preference shares, 0.0285 Rubles per share	27,678
Total	**55,328**

29. Contingencies and Operating Risks

Operating Environment of the Company

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

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

Taxation

Russian tax, currency and customs legislation is subject to varying interpretations and changes, which can occur frequently. Recent events within the Russian Federation suggest that the tax authorities are taking a more assertive position in its interpretation of the legislation and assessments and as a result, it is possible that transactions and activities that have not been challenged in the past may be challenged. As such, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

29. Contingencies and Operating Risks (continued)

Taxation (continued)

As at December 31, 2004, management believes that its interpretation of the relevant legislation is appropriate and that it is most likely that the Company's tax, currency and customs positions will be sustained. However, it is possible that in certain instances of interpreting the legislation requirements and assessing the relevant tax liabilities management of the Company may have assumed the position, which could subsequently be challenged by the government fiscal authorities as one lacking sustainable basis. The Company intends to defend its position on those issues. As at December 31, 2004, the financial statements do not contain adjustments which may become necessary due to these uncertainties and positions assumed by the Company.

In February 2005 tax authorities raised significant claim against OJSC Dalsvyaz, a company of the Svyazinvest Group, as a result of tax examination of the company’s operations for the years 2001-2002.

The Company does not expect similar claims since OJSC Dalsvyaz disagreed with the claim raised by tax authorities, brought the case before the court to contest tax authorities’ claim, and estimated the probability of settle of the claim as high. Additionally, tax authorities carried out examination in other companies of the Svyazinvest Group for the same periods, and claims raised against them were insignificant.

Insurance Coverage

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

Legal Proceeding

The Russian legal system is characterized by (1) inconsistencies between and among laws, Presidential decrees, and Russian governmental, ministerial and local orders, decisions, and resolutions and other acts; (2) conflicting local, regional and federal rules and regulations; (3) the relative inexperience in legislation interpretation.

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.

During the year, the Company was involved in a number of court proceedings (both as a plaintiff and a defendant) arising in the ordinary course of business. In the opinion of management, there are no current legal proceedings or other claims outstanding, which could have a material effect on the result of operations or financial position of the Company and which have not been accrued or disclosed in these consolidated financial statements.

29. Contingencies and Operating Risks (continued)

Licenses

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

30. Commitments

Guarantees issued

As of December 31, 2004 the Company has guaranteed credit line facilities provided by Sberbank and Rosbank to CJSC "RTC-Leasing", a lessor of telecommunication equipment. The guarantees amounted to 3,185,693 and 377,150, respectively (2003 – 1,887,827 and 207,150 respectively).

Finance leasing

In 2004 the Company entered into several finance leases with OJSC RTC-Leasing. The equipment under these leases will be delivered in 2005. Cost of equipment acquired through these leases, inclusive of installation and other capitalized services approximated 577,454.

Capital investments

As of December 31, 2004 and 2003 the Company has commitments of 2,330,700 and 987,388, respectively, for capital investments into modernization and expansion of its network.

According to agreements executed by the Company in 2004, it has undertaken to invest 204,672 into subsequent installation of Oracle E-business software. The Company intends to finalize implementation of the system in 2008.

31. Balances and Transactions with Related Parties

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

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

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

(in thousand rubles)

31. Balances and Transactions with Related Parties (continued)

Sale of goods and services

During the reporting period the Company rendered services to the following related parties:

Related party	Relationship	Type of sales	Price determination method	2004	2003
LLC "Yug - Giprosvyaz"	Associate	Rent of property	Arm's length terms	**23,186**	8,062
CJSC "Volgograd – GSM"	Associate	Telecommunication services	Arm's length terms	**122,870**	62,692
TOTAL:				**146,056**	**70,754**

Purchases

During the reporting period the following related parties rendered services to the Company:

Related party	Relationship	Type of sales	Price determination method	2004	2003
LLC "Yug - Giprosvyaz"	Associate	Project engineering	Arm's length terms	**525,968**	104,799
CJSC "Volgograd – GSM"	Associate	Telecommunication services	Arm's length terms	**6,065**	3,884
TOTAL:				**532,033**	**108,683**

Balances with related parties

As of December 31, 2004 balances with related parties comprise the following:

Accounts receivable:

Related party	Relationship	Type of receivable	2004	2003
LLC "Yug - Giprosvyaz"	Associate	Rent of property	**16,240**	35,189
CJSC "Volgograd – GSM"	Associate	Telecommunication services	**825**	3,289
TOTAL:			**17,065**	**38,478**

Accounts payable:

Related party	Relationship	Type of payable	2004	2003
LLC "Yug - Giprosvyaz"	Associate	Project engineering	**182,440**	7,437
CJSC "Volgograd – GSM"	Associate	Telecommunication services	**946**	1,022
TOTAL:			**183,386**	**8,459**

(in thousand rubles)

31. Balances and Transactions with Related Parties (continued)

OJSC Svyazinvest

The Company's parent entity - OJSC Svyazinvest - was wholly owned by the Russian Government until July 1997 when the Government sold 25% plus one share of the Charter Capital of OJSC Svyazinvest to the private sector.

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

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

As of December 31, 2004 and 2003 the Company had no outstanding amount payable to Svyazinvest according to loan agreement.

OJSC Rostelecom

OJSC Rostelecom, a majority owned subsidiary of OJSC Svyazinvest, is the primary provider of domestic long distance and international telecommunications services in the Russian Federation. The annual expense associated with traffic carried by OJSC Rostelecom and terminated outside of the Company's network is stated as interconnection charges. Further, OJSC Rostelecom uses the Company's network to provide incoming long-distance and international traffic to its subscribers and partner operators. Transactions undertaken by the Company with OJSC Rostelecom reported in the accompanying consolidated financial statements as at December 31, 2003 and 2002 and for the years then ended were as follows:

	2004	**2003**
Expenses on traffic transfer and rent of channels from Rostelecom	**1,878,146**	1,546,056
Revenue received from Rostelecom	**(582,799)**	(294,376)
Accounts payable to Rostelecom as at December 31	**(134,099)**	(133,539)

Transactions with government organizations

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

Government subscribers accounted for approximately 6.9% of trade accounts receivable as of December 31, 2004 (2003 - 11.1%). Amounts outstanding from government subscribers as of December 31, 2004, amounted to 134,387 (2003 - 123,108).

31. Balances and Transactions with Related Parties (continued)

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

Non-commercial partnership Center for Research of the Problems in Development of Telecommunications (hereinafter ”the Partnership”) is an entity OJSC Svyazinvest controls through its subsidiaries. The Company has an agreement with the Partnership, under which it provides funding for industry research and common administrative activities on behalf of the Company and other subsidiaries and associates of OJSC Svyazinvest. Payments to the Partnership included in other operating expenses in the accompanying consolidated statement of operations for the year ended December 31, 2004 amounted to nil (2003 - 134,665).

NPF “Telecom-Soyuz”

The Company has a number of pension agreements with NPF “Telecom-Soyuz” which is a party related to OJSC Svyazinvest (Note 22). OJSC Svyazinvest hold the majority in the Board of Directors of NPF “Telecom-Soyuz” (“the Fund”), because Svyazinvest Group is the main contributor of this Fund. Payments from the Company to the Fund in 2004 amounted to 61,074 (2003 - 56,483).

Compensation to Key Management Personnel

Key management personnel comprise members of Management Board and Board of Directors of the Company, totaling 32 and 34 persons as at 31 December 2004 and 2003, respectively. Total compensation to key management personnel included in the statement of operations line “Wages, salaries, other employee benefits and payroll taxes” amounted to 67,192 and 61,558 for the years ended 31 December 2004 and 2003, respectively.

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

32. Financial Instruments

Fair value

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

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

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

Credit risk

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

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

(in thousand rubles)

32. Financial Instruments (continued)

Credit risk (continued)

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

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

Foreign exchange risk

Foreign exchange risk is the risk that fluctuations in exchange rates will adversely affect items in the Company’s statement of operations, balance sheet and/or cash flows. Foreign currency denominated liabilities (see Notes 18, 19 and 20) give rise to foreign exchange exposure.

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

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

Interest rate risk

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

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

As of December 31, 2003:	**< 1 year**	**1-5 years**	**> 5 years**	**Total**
Fixed rate				
Short–term obligations	3,010,603	–	–	**3,010,603**
Long–term obligations	1,825,907	4,788,827	23,845	**6,638,579**
Finance lease obligations	619,794	1,710,467	–	**2,330,261**
Floating rate				
Long–term obligations	1,080,926	156,236	–	**1,237,162**

As of December 31, 2004:	**< 1 year**	**1–5 years**	**> 5 years**	**Total**
Fixed rate				
Short–term obligations	**3,816,150**	**–**	**–**	**3,816,150**
Long–term obligations	**2,836,215**	**8,021,636**	**38,489**	**10,896,340**
Finance lease obligations	**988,925**	**2,210,188**	**–**	**3,199,113**
Floating rate				
Long–term obligations	**2,309,086**	**3,447,536**	**–**	**5,756,622**

32. Financial Instruments (continued)

Interest rate risk (continued)

Interest on financial instruments classified as floating rate is revised at intervals less than one year.

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

The Company has no significant interest-bearing assets.

33. Subsequent Events

Bonds

In February 2005 Series 02 bondholders exercised the right of earlier redemption. Series 02 bonds were further placed by the Company on over-the-counter market under the original terms.

Sale of CJSC "CMTO"

In April 2005, the Company's Board of Directors approved the sale of 100% shares of CJSC "CMTO" (a subsidiary) for 45,010.

Dividends

In June 2005, the general meeting of the Company's shareholders approved dividends for 2004 in the amount of 0.0285 Rubles per preference share and 0.0093 Rubles per ordinary share. Total dividends declared amounted to 55,328 (2003 – 348,439). Dividends for the year ended December 31, 2004 are payable during 2005 and will be accrued in the financial statements for the year ended December 31, 2005 (Note 28).

Telecommunication Reform

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

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

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

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

32. Financial Instruments (continued)

Unified Social Tax

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

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

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