PJSC MOSCOW CITY TELEPHONE NETWORK AND SUBSIDIARIES

Independent Auditors' Report

Consolidated Financial Statements
Years Ended December 31, 2006, 2005
and 2004

PJSC MOSCOW CITY TELEPHONE NETWORK AND SUBSIDIARIES

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INDEPENDENT AUDITORS' REPORT

To the shareholders of PJSC Moscow City Telephone Network:

We have audited the accompanying consolidated balance sheets of PJSC Moscow City Telephone Network ("MGTS") and its subsidiaries (collectively – the "Group") as of December 31, 2006, 2005 and 2004, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Group as of December 31, 2006, 2005 and 2004, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche

April 17, 2007
(May 25, 2007 as to Note 27)

CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2006, 2005 AND 2004
(thousands of US dollars, except for share amounts)

	2006	2005	2004
ASSETS			
CURRENT ASSETS:			
Cash and cash equivalents (Note 5)	$ 26,209	$ 27,483	$ 28,748
Short-term investments (Note 6)	58,224	61,675	25,609
Accounts receivable, advances and taxes receivable, net (Note 7)	101,467	97,792	75,323
Inventories and spare parts	18,395	14,501	15,550
Deferred income taxes, net (Note 18)	14,845	9,562	11,432
Assets held for sale (Note 3)	-	15,260	-
Total current assets	219,140	226,273	156,662
NON-CURRENT ASSETS			
Property, plant and equipment, net (Note 8)	1,276,404	1,038,141	976,966
Advance payments for property, plant and equipment	15,505	8,985	7,248
Intangible assets, net (Note 9)	33,598	27,058	19,494
Long-term investments (Note 10)	440,554	7,497	171,332
Restricted cash (Note 11)	4,008	2,272	972
Long-term trade and other receivables (Note 12)	17,367	-	-
Total non-current assets	1,787,436	1,083,953	1,176,012
TOTAL ASSETS	**$ 2,006,576**	**$ 1,310,226**	**$ 1,332,674**
LIABILITIES AND SHAREHOLDERS' EQUITY			
CURRENT LIABILITIES:			
Short-term debt (Note 13)	$ 112,063	$ 83,123	$ 72,278
Accounts payable, taxes payable and accrued liabilities (Note 14)	65,122	56,456	39,733
Deferred revenue, current portion (Note 15)	50,084	47,964	46,605
Call and put option (Note 10)	150,000	-	-
Total current liabilities	377,269	187,543	158,616
NON-CURRENT LIABILITIES			
Long-term debt (Note 13)	446,876	110,631	117,282
Deferred revenue (Note 15)	114,845	109,958	97,538
Retirement and post-retirement benefits (Note 16)	10,181	16,217	11,513
Property, plant and equipment contributions (Note 17)	113,354	102,746	103,822
Deferred income taxes, net (Note 18)	29,349	17,323	22,099
Payable to Sistema Hals (Note 2)	8,066	-	-
Total non-current liabilities	722,671	356,875	352,254
TOTAL LIABILITIES	**$ 1,099,940**	**$ 544,418**	**$ 510,870**
COMMITMENTS AND CONTINGENCIES (Note 26)	-	-	-
SHAREHOLDERS' EQUITY:			
Preferred stock, 15,965,850 shares authorized, issued and outstanding (Note 19)	$ 22,538	$ 22,538	$ 22,538
Common stock, 79,829,200 shares authorized, issued and outstanding (Note 19)	112,462	112,462	112,462
Shares of Comstar UTS (Note 10)	(173,441)	(173,441)	-
Additional paid-in capital	61,889	61,806	61,806
Retained earnings	778,061	715,095	565,572
Accumulated other comprehensive income (Note 3)	105,127	27,348	59,426
Total shareholders' equity	906,636	765,808	821,804
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	**$ 2,006,576**	**$ 1,310,226**	**$ 1,332,674**

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

PJSC MOSCOW CITY TELEPHONE NETWORK AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004
(thousands of U.S. dollars except for share and per share amounts)

	2006	2005	2004
Operating revenues (Note 20)	$ 802,168	$ 639,624	$ 480,847
Operating expenses, net (Note 21)	(549,190)	(445,430)	(381,337)
OPERATING INCOME	252,978	194,194	99,510
Interest income	6,312	3,773	3,430
Interest expense	(16,073)	(15,035)	(17,133)
Change in fair value of the call and put option (Note 10)	(60,000)	-	-
Currency transaction gain/(loss), net	6,584	841	(470)
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAX EXPENSE AND INCOME FROM AFFILIATES	189,801	183,773	85,337
Income tax expense (Note 18)	(64,964)	(43,262)	(26,622)
Income from equity method investees	437	21,023	16,133
INCOME FROM CONTINUING OPERATIONS	125,274	161,534	74,848
DISCONTINUED OPERATIONS (Note 4)			
Gain from operations of P-Com (net of loss on disposal)	-	-	1,337
Income tax expense	-	-	(1,158)
NET GAIN ON DISCONTINUED OPERATIONS	-	-	179
NET INCOME	**$ 125,274**	**$ 161,534**	**$ 75,027**
EARNINGS PER SHARE			
Weighted average number of common shares outstanding	79,829,200	79,829,200	79,829,200
Earnings per common share before gain from discontinued operations – basic	$ 1.31	$ 1.69	$ 0.78
Gain from discontinued operations	-	-	-
Earnings per common share – basic (Note 23)	**$ 1.31**	**$ 1.69**	**$ 0.78**
Earnings per common share before gain from discontinued operations – diluted	$ 1.31	$ 1.69	$ 0.78
Gain from discontinued operations	-	-	-
Earnings per common share – diluted (Note 23)	**$ 1.31**	**$ 1.69**	**$ 0.78**

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

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004
(thousands of U.S. dollars unless otherwise stated)

	2006	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$ 125,274	$ 161,534	$ 75,027
Adjustments to reconcile net income to cash provided by operating activities:			
Gain on discontinued operations	-	-	(179)
Allowance for doubtful accounts and other allowances	7,462	3,326	(500)
Depreciation and amortization	103,035	74,496	68,011
Currency transaction (gain)/loss, net	(6,584)	(841)	470
Income from equity method investees, net of dividends received	-	(20,016)	(15,659)
Stock-based compensation	83	-	-
Deferred gain amortization	-	-	(735)
Deferred taxes	5,840	(2,477)	3,070
Post-retirement benefits	(7,306)	5,014	6,315
Loss on disposal of property, plant and equipment, net	4,876	7,694	4,166
Gain on disposal of assets held for sale	(8,544)	-	-
Gain on compensation of losses from third parties	(9,217)	(2,959)	(634)
Gain on disposal of long-term investments	-	(1,954)	-
Change in fair value of call and put option	60,000	-	-
Changes in operating assets and liabilities:			
Accounts receivable, advances and taxes receivable	(19,399)	(28,500)	(19,321)
Inventories and spare parts	(2,209)	490	(865)
Accounts payable, taxes payable and accrued liabilities	13,112	623	10,826
Deferred revenue	(4,043)	20,357	26,665
Net cash provided by operating activities	$ 262,380	$ 216,787	$ 156,657
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchases of property, plant and equipment	$ (233,646)	$ (141,196)	$ (121,585)
Purchases of intangible assets	(13,698)	(13,090)	(10,101)
Proceeds from sale of property, plant and equipment and assets held for sale	26,789	1,351	1,323
Proceeds from sale of long-term investments	-	1,972	652
Sales (purchases) of short-term investments, net	2,350	(34,466)	(13,622)
Purchases of long-term investments	(400,020)	-	-
Net cash used in investing activities	$ (618,225)	$ (185,429)	$ (143,333)

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004 (CONTINUED)
(thousands of U.S. dollars unless otherwise stated)

	2006	2005	2004
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from borrowings	$ 826,465	$ 89,153	$ 89,059
Repayments of borrowings other than vendor financing	(452,117)	(82,064)	(76,122)
Repayments of vendor financing	(9,410)	(16,616)	(12,780)
Payments on capital leases	(11,922)	(10,506)	(9,278)
Dividends paid	(54)	(11,559)	(9,228)
Net cash provided by/(used in) financing activities	$ 352,962	$ (31,592)	$ (18,349)
EFFECTS OF CURRENCY TRANSLATION ON CASH AND CASH EQUIVALENTS	1,609	(1,032)	2,007
NET DECREASE IN CASH AND CASH EQUIVALENTS	$ (1,274)	$ (1,265)	$ (3,018)
CASH AND CASH EQUIVALENTS, beginning of year	27,483	28,748	31,766
CASH AND CASH EQUIVALENTS, end of year	$ 26,209	$ 27,483	$ 28,748
SUPPLEMENTAL INFORMATION:			
Cash paid for interest, net of amounts capitalized	$ 16,245	$ 14,232	$ 13,649
Income taxes paid	$ 66,532	$ 45,779	$ 25,478
NON-CASH INVESTING AND FINANCING ACTIVITIES:			
Property, plant and equipment contributions (Note 17)	$ 5,387	$ 6,281	$ 13,597
Equipment acquired through vendor financing (Note 13)	$ 2,745	$ 2,921	$ 20,714
Equipment acquired under capital leases (Note 13)	$ -	$ 25,817	$ 25,765
Non-cash consideration paid to acquire equity interest in Svyazinvest (Note 10)	$ 90,000	$ -	$ -
Cost of construction payable to Sistema Hals, related party (Note 2)	$ 8,437	$ -	$ -

In addition, non-cash investing activities during the year ended December 31, 2005 included disposals of shares of subsidiaries and affiliates, as described in Note 10.

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

PJSC MOSCOW CITY TELEPHONE NETWORK AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY FOR THE YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004
(thousands of U.S. dollars, except for share and per share amounts)

	Preferred stock		Common stock, authorized, issued and outstanding						
	Shares	**Amount**	**Shares**	**Amount**	**Shares of Comstar UTS**	**Additional paid-in capital**	**Retained earnings**	**Accumulated other comprehensive income**	**Total**
Balances at January 1, 2004	**15,965,850 $**	**22,538**	**79,829,200 $**	**112,462 $**	**- $**	**61,806 $**	**500,408 $**	**11,713 $**	**708,927**
Net income	-	-	-	-	-	-	75,027	-	75,027
Dividends declared on preferred shares	-	-	-	-	-	-	(6,576)	-	(6,576)
Dividends declared on common shares	-	-	-	-	-	-	(3,287)	-	(3,287)
Translation adjustment (Note 3)	-	-	-	-	-	-	-	47,713	47,713
Balances at December 31, 2004	**15,965,850 $**	**22,538**	**79,829,200 $**	**112,462 $**	**- $**	**61,806 $**	**565,572 $**	**59,426 $**	**821,804**
Net income	-	-	-	-	-	-	161,534	-	161,534
Dividends declared on preferred shares	-	-	-	-	-	-	(6,776)	-	(6,776)
Dividends declared on common shares	-	-	-	-	-	-	(5,235)	-	(5,235)
Translation adjustment (Note 3)	-	-	-	-	-	-	-	(32,078)	(32,078)
Restructuring of Comstar UTS (Note 10)	-	-	-	-	(173,441)	-	-	-	(173,441)
Balances at December 31, 2005	**15,965,850 $**	**22,538**	**79,829,200 $**	**112,462 $**	**(173,441)$**	**61,806 $**	**715,095 $**	**27,348 $**	**765,808**
Net income	-	-	-	-	-	-	125,274	-	125,274
Translation adjustment (Note 3)	-	-	-	-	-	-	-	77,779	77,779
Stock-based compensation granted by Comstar UTS to MGTS' employees, (Note 22)	-	-	-	-	-	83	-	-	83
Comstar UTS' share in the fair value of the non-cash consideration paid to acquire equity interest in Svyazinvest (Note 10)	-	-	-	-	-	-	(62,308)	-	(62,308)
Balances at December 31, 2006	**15,965,850 $**	**22,538**	**79,829,200 $**	**112,462 $**	**(173,441)$**	**61,889$**	**778,061 $**	**105,127 $**	**906,636**

Dividends declared for 2004 were U.S. dollars 0.42 (USD) and USD 0.07 per preferred and common share, respectively.

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

(thousands U.S. dollars unless otherwise stated)

1. THE GROUP

Description of Business – Public Joint-Stock Company Moscow City Telephone Network ("MGTS") and its subsidiaries (collectively, the "Group") operates one of the largest metropolitan communication networks in the world. Founded in 1882 and nationalized in 1917, MGTS was privatized and became an open joint stock company in 1994. MGTS provides telecommunication services to residential subscribers, state-financed institutions and businesses within the city of Moscow.

The principal activities of the Group's major subsidiaries as of December 31, 2006 are as follows:

Operating Entities	Short Name	Principal activity
AMT	AMT	Radiotelephony services and repair of telecommunication equipment
Petrodvor	Petrodvor	Providing rent and other services to the entities of the Group
MGTS Finance S.A.	MGTS Finance	Holding the Group's shares in JSC Comstar – United TeleSystems

In November 2005, JSFC Sistema ("Sistema"), the Group's ultimate controlling shareholder, contributed its shareholdings in MGTS to the share capital of Comstar – United TeleSystems ("Comstar UTS"), Sistema's subsidiary providing the fixed line communication services, including voice, Internet dial-up and broadband, and various value added services, to commercial and residential customers throughout the Moscow metropolitan area (see also Note 10 for additional information on restructuring of Comstar UTS). Effective November 2005, the Group's immediate parent is Comstar UTS.

Local telephone services are regulated tariff services and changes in rate structure are subject to approval of Federal Tariff's Service ("FTS"). Further, effective January 1, 2006 tariffs for services provided to other operators, such as traffic charges, connection fees and line rental services became regulated. In 2006, 2005 and 2004, approximately 70%, 50% and 55%, respectively, of the Group's revenues were generated from regulated tariff services. Fixed monthly fees approved by FTS during 2006 are presented in the table below:

In Russian Rubles:	January 1 - September 30, 2005	October 1, 2005 - December 31, 2006
Residential subscribers (including VAT)	170	200
State-financed institutions	170	200
Corporate entities	200	210

Residential customers have been charged a fixed monthly fee, while corporate entities and state-financed institutions have been charged for local traffic in addition to a fixed monthly fee.

In December 2006, regulatory bodies approved new tariffs for MGTS, which come in effect from February 1, 2007. Instead of a single "unlimited" tariff plan for residential subscribers with a fixed monthly fee of 200 Russian Rubles ("RUB") (approximately US Dollar ("USD") 7.60), three tariff plans were introduced: (i) a per-minute plan with a monthly fee of RUB 125 (approximately USD 4.80) and per minute charges of RUB 0.28 (approximately USD 0.01),

(ii) a combined plan with a monthly fee of RUB 229 (approximately USD 8.70), which includes 370 prepaid minutes, and per minute charges of RUB 0.23 (approximately USD 0.01) for each additional minute, and (iii) an unlimited plan with a monthly fee of RUB 380 (approximately USD 14.50). In addition, new tariffs for the corporate subscribers were introduced. Currently, management is unable to estimate the effect introduction of new tariffs will have on the Group's consolidated financial statements.

2. INVESTMENT PROGRAM

In December 2003, the Group announced its long-term investment program for the period from 2004 to 2012 providing for extensive capital expenditures, including expansion and full digitalization of the Moscow telephone network. The program was approved by a resolution of the Moscow City Government on December 16, 2003. At the inception of the investment program, capital expenditures were estimated to be approximately $1.6 billion and included reconstruction of approximately 350 local telephone stations and installation of approximately 4.3 million of new phone lines numbers. As a result of investment program, new digital equipment will be installed at telephone nodes buildings, and a substantial amount of floor space will become available after the replacement of analogue switching equipment. As a result of investment program, additional floor space, constructed is expected to be sold to third parties or rented out. Currently MGTS is evaluating future uses of each of the building subject to the investment program. There are 114 automatic telephone station buildings which are to be reconstructed or rebuilt in the course of the implementation of the investment program.

In November 2006, MGTS signed an agreement with the Moscow City Government under which MGTS' investment program was approved. Under the agreement, the Moscow City Government is entitled to receive not less than 30% of the market value of additional floor space constructed during the course of the investment program. The obligation arises at the time reconstruction of each property is completed. In December 2005, MGTS made a prepayment of $9.9 million to Moscow City Government ($10.4 million as of December 31, 2006) under this program which will be offset against the future liability arising as a result of the investment program (Note 12).

In course of implementation of the investment program, MGTS entered into a series of agreements with Sistema Hals, a subsidiary of Sistema, related to project development and reconstruction of the telephone stations. The main portion of the work under the contracts to be performed between 2008 and 2012. Under the agreement with Sistema Hals, MGTS reimburses all expenses in relation to the construction process, a margin of 4.75% on incurred expenses and a fixed fee of $0.04 million for preliminary study of each building. During 2006, the work on projects development and site preparation was performed by Sistema Hals for 48 sites, which resulted in $8.0 million addition to construction in progress in 2006 and recognition of a payable to Sistema Hals in the same amount (Note 25). There were not any construction or other works were performed for other sites in 2006, as related business plans are still under development.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND RECENT ACCOUNTING PRONOUNCEMENTS

Basis of Presentation – The accompanying financial statements have been prepared in conformity with the accounting principles generally accepted in the United States of America ("U.S. GAAP"). The Group's entities maintain accounting records in Russian Rubles in accordance with the requirements of Russian accounting legislation. The accompanying financial statements differ from the financial statements prepared for statutory purposes in the Russian Federation (the "RF") in that they reflect certain adjustments, appropriate to present the financial position, results of operations and cash flows in accordance with U.S. GAAP, which are not recorded in the statutory accounting books of the Group's entities.

Principles of Consolidation – The consolidated financial statements for the years ended December 31, 2006, 2005 and 2004 include the accounts of MGTS and its wholly-owned subsidiaries – AMT, Petrodvor and MGTS Finance S.A. All significant intercompany transactions, balances and unrealized gains and losses have been eliminated.

Use of Estimates – The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses for the period. Actual results could differ from these estimates.

Examples of significant estimates include the allowance for doubtful accounts, the useful life and recoverability of long-lived assets, average length of subscribers relationship, fair value of derivative financial instruments and valuation allowances on deferred taxes.

In connection with the MGTS' acceleration of phasing out of analogue switching equipment, which is being replaced by digital equipment and is expected to be completely disposed of by 2012 effective July 1, 2006 management revised its estimates of residual lives of such analogue equipment, which resulted in an increase in depreciation and amortization charge for the year ended December 31, 2006 by approximately $10.8 million (Note 8), and in a decrease in basic and diluted earnings per common share by USD 0.1.

Concentration of Business Risk – The Group's business activities are within the Russian Federation ("RF"). Laws and regulations affecting businesses operating in the RF are subject to rapid changes, which could impact the Group's assets and operations.

Foreign Currency Translation – The Group follows a translation policy in accordance with the provisions of SFAS No. 52, *Foreign Currency Translation* ("SFAS 52").

Management has determined that the Group's functional currency is the Russian Ruble. The Group selected the USD as its reporting currency and translates functional currency financial statements of its entities into USD. Assets and liabilities are translated at the exchange rates current at the balance sheet date, while income and expense items are translated at the weighted average exchange rate for the year in which such transactions occurred. The resulting translation adjustment is recorded as a separate component of other comprehensive income in the accompanying consolidated statement of changes in shareholders' equity.

The official rate of exchange, as set by the Central Bank of the RF, between the Ruble and the U.S. dollar at December 31, 2006 was 26.33 Rubles to 1 U.S. dollar (December 31, 2005: 28.78, December 31, 2004: 27.75).

The Ruble is not a fully convertible currency outside of the territory of the RF. The translation of RUB-denominated assets and liabilities into USD for the purpose of these financial statements does not indicate that the Group could or will in the future convert the reported values of the assets and liabilities in USD.

Revenue Recognition – The Group's revenues are principally derived from the provision of local telephone and data transmission services which consist of (i) usage charges, including revenues received under the Calling Party Pays ("CPP") arrangements,(ii) monthly subscription fee, (iii) agent fees for initiation of domestic and international long-distance calls, (iv) service activation and installation fees, (v) revenues from use of prepaid pay phone cards and (vi) charges for value-added telecommunication services. The Group records revenues over the periods they are earned as follows:

(i) Revenues derived from local telephone usage and data transmission are recognized as the services are provided. Starting June 1, 2006 MGTS charges its subscribers for calls made to cell phones under the newly introduced CPP rule. The Group recognizes these revenues on a gross basis as it is the principal provider of the services; amounts paid to mobile operators are recorded as interconnect expenses;

(ii) Monthly telephone service fees are recognized in the month during which the telephone services are provided to customers;

(iii) Domestic and international long-distance ("DLD/ILD") services are provided to the Group's subscribers by licensed long distance operators - Rostelecom and MTT, a subsidiary of Sistema. Fees received from these operators for calls initiated by MGTS subscribers are recorded in the period earned;

(iv) Upfront fees received for activation and installation of wireline and data transmission services are deferred and recognized over the expected customer relationship period. According to management estimates, the customer relationship period for wireline voice phone subscribers is 15 years for residential customers and 5 years for all other categories of subscribers;

(v) Revenues from sale of payphone calling cards are recognized as cards are used by customers or expire;

(vi) Revenues derived from value-added telecommunication services are recognized when the services are provided to customers.

Other related telecommunications service revenues are recognized as follows:

(i) Interconnection fees from other telecommunications operators are recognized when the services are provided to the operators;

(ii) Lease income from operating leases is recognized over the term of the lease.

Historically, the Group has entered into interconnect agreements under which the Group provides services to, and receives services from, other operators for a fixed annual fee, regardless of the volume of the outgoing or incoming traffic. Revenues under these agreements are recognized in the amount of the net fixed fee receivable by the Group. Following the introduction of the new interconnect rules, these arrangements are being phased out and replaced with agreements under which the Group bills its counterparties for the use of its network and pays other operators for the calls of its subscribers to other operators' customers. Revenues under these arrangements are recognized in the amount of revenue receivable by the Group and expenses are recorded for charges payable by the Group.

Revenue is recognized when cash collection is considered probable.

Management believes that the Group is not subject to the requirements of Statement of Financial Accounting Standards No. 71, *Accounting for the Effects of Certain Types of Regulation* ("SFAS 71") as the regulated rates for certain types of services are not designed to recover the specific Group's costs of providing the regulated services or products.

Contributions from the RF Budget – Before January 1, 2005, MGTS was required to grant discounts ranging from 20% to 100% on installation and monthly fees to certain categories of residential subscribers, such as pensioners, military veterans and disabled individuals, and was entitled to reimbursement from the RF for these discounts. Due to the lack of certainty of reimbursement, MGTS did not recognize any revenues related to these amount until such amounts were collected. During the year ended December 31, 2006, MGTS received $25.8 million related to amounts due from the year 2004. This amount was recorded as revenues in the year ended December 31, 2006. The Group did not recognize revenues or receivables in respect of the remaining compensation from the budget in the amount of approximately 957.0 million rubles ($36.3 million as of December 31, 2006) due to uncertainty as to the collectibility of the amounts.

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

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

Fair Value of Financial Instruments – Financial instruments carried on the balance sheet include cash and bank balances, receivables, investments, accounts payable, capital lease obligations, debt and a liability under the call and put option agreement granted in connection with acquisition of Svyazinvest shares (Note 10). The particular recognition methods adopted are disclosed in the individual policy statements associated with each item.

Fair values of corporate bonds issued by MGTS are disclosed in Note 13.

Accounts Receivable – Accounts receivable are stated at their net realizable value after deducting an allowance for doubtful accounts. Such allowance reflects either specific cases of delinquency or defaults or estimates based on evidence of collectibility.

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

Inventories and Spare Parts – Inventories and spare parts comprise cables, spare parts, telephones, accessories and other inventory are stated at the lower of cost calculated using the weighted average method or market value.

Assets Held for Sale – Assets held for sale comprise the cost of a building reconstructed on behalf of the Group with intention to sell to a third party and sold in the first quarter of 2006.

Property, Plant and Equipment – Property, plant and equipment is stated at cost less accumulated depreciation, except for assets contributed by Sistema free of charge, which are initially recorded at fair values.

The group receives telecommunication infrastructure which is intended to operate as an integral part of the Moscow city wire line network from the real estate constructors free of charge as provided by the regulations of the city government. Property, plant and equipment which are contributed to the Group free of charge are capitalized at its market value at the date of transfer and deferred revenue is recorded and amortized to the consolidated statement of operations over the contributed assets' life.

Significant renovations are capitalized if they extend the life of the asset or significantly increase its revenue generating capacity. Repairs and maintenance are charged to the statement of operations as incurred.

The Group accounts for leases based on the requirements of SFAS No. 13, "Accounting for Leases." Leases are classified as capital leases whenever the terms of the lease transfer substantially all of the benefits and rewards incident to the ownership. All other leases are classified as operating leases.

Capital leases are recorded at the fair market value of the asset or the present value of future minimum lease payments, whichever is lower. The discount rate used in determining present value of the minimum lease payments is the Group's incremental borrowing rate, unless (1) it is practicable to learn the implicit rate computed by the lessor and (2) the implicit rate is less than the Group's incremental borrowing rate. If both of those conditions are met, the interest rate implicit in the lease is used.

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

Property, plant and equipment is depreciated on a straight-line basis over the following estimated useful lives:

	Years
Buildings	47
Site improvements	44
Transmission devices	31
Analogue telecommunication equipment[1]	17
Digital telecommunication equipment	10
Other equipment	3-21

Property, plant and equipment held and used by the Group is reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of assets may have been impaired. Management is not aware of any indicators of impairment relating to the Group's investments in property, plant and equipment during the years ended December 31, 2006, 2005 and 2004.

The Group incurs costs associated with operating and other equipment, which require installation and related works to enable assets to commence revenue generating activities. All costs necessarily incurred which are directly attributable to the construction, preparation and installation of an item to commence revenue-generating activities except for rental costs, are capitalized.

Intangible Assets – Intangible assets comprise mostly billing systems and other software and are stated at acquisition cost. Amortization is computed on a straight-line basis over their estimated useful lives, generally five years.

Stock-Based Compensation – MGTS accounts for stock-based compensation granted to its employees by Comstar UTS (see Note 22) in accordance with provisions of Statement of Financial Accounting Standrds No. 123R (revised 2004), *Share Based Payment* ("SFAS 123R"). Under SFAS No. 123R, companies must calculate and record the cost of equity instruments, such as stock options or restricted stock, awarded to employees for services received in the statement of operations. The cost of the equity instruments is to be measured based on the fair value of the instruments on the date they are granted or, if the number of shares to be issued or the exercise price is unknown, remeasured at each reporting date and is required to be recognized over the period during which the employees are required to provide services in exchange for the equity instruments. Further, under SFAS No. 123R, the companies shall account for share-based compensation awarded to an employee of the reporting entity by a related party as compensation for services provided to the entity under SFAS No. 123R, unless the transfer is clearly for a purpose other than compensation for services to the reporting entity.

Asset Retirement Obligations – In accordance with SFAS No. 143, *Accounting for Asset Retirement Obligations*, ("SFAS 143") the Group calculates an asset retirement obligation and an associated asset retirement cost when the Group has a legal obligation in connection with the retirement of tangible long-lived assets. The Group's obligations under SFAS No. 143 arise from certain of its leases and relate primarily to the cost of removing equipment from such lease sites. As of December 31, 2006, the estimated assets retirement obligations were not significant to the Group's consolidated cash flows, financial position and results of operations.

Investments – Long term investments in non-marketable corporate shares where the Group owns more than 20% of share capital, but does not have the ability or intent to control or exercise significant influence over operating and financial policies, as well as investments in corporate shares where the Group owns less than 20% of share capital and does not have the ability or intent to control or exercise significant influence over operating and financial policies are accounted for at cost of acquisition. Management periodically assesses the ability to recover the carrying values of such investments and records an impairment loss if, based upon the expected undiscounted cash flows,

[1] Analogue switching equipment of MGTS, depreciation of which has been accelerated to reflect the anticipated disposal of such equipment as discussed above, is depreciated over remaining useful lives ranging from 1 to 6 years.

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

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

Prior to December 2005, MGTS owned 51% of voting common shares of Mediatel (now named Sitronics Telecom Solutions), with the remaining shares owned by Concern SITRONICS, a subsidiary of Sistema. Sitronics Telecom Solutions, a company incorporated in the RF, is providing support and maintenance services related to telecommunication equipment and software. In January 2004, MGTS entered into an agreement with Concern SITRONICS in respect of corporate governance of Mediatel that provided that control over operating and financial policies of Mediatel (including, but not limited to, the rights to establish its operating and capital decisions, including budgets, and the rights to select and set the compensation of management responsible for implementation of these decisions) was transfered to Concern SITRONICS. In 2005 and 2004, the Group's investment in Mediatel was accounted for using the equity method of accounting based upon the above agreement and the fact that the Group had ceded operational control of Mediatel to Concern SITRONICS. In December 2005, MGTS sold its 51% stake in Mediatel to Concern SITRONICS for cash consideration of $1.9 million.

Prior to November 2005, MGTS owned 51% of voting common shares of MTU-Inform, while Sistema and its subsidiary owned 48% of MTU-Inform. In May 2004, Sistema announced completion of the operational merger of its three digital operators: MTU-Inform, Comstar and Telmos. Concurrently, MGTS and Sistema agreed to transfer the operating and financial control over the operations of MTU-Inform to Comstar UTS. In July 2004, MTU-Inform entered into an agreement with Comstar UTS for the transfer to Comstar UTS of the management function of MTU-Inform. As a result of the contractual arrangement, the Group ceased to have control over MTU-Inform's operations. Following the transfer of control over MTU-Inform, the Group's share in the earnings of MTU-Inform for the years ended December 31, 2005 and 2004 was recorded using the equity method of accounting.

Promissory notes purchased by the Group and loans granted are classified as held-to-maturity financial instrument and carried at amortized cost. Held-to-maturity investments are reviewed for impairment whenever impairment indicators exist.

Retirement and Post-Retirement Benefits – Contributions are made to the governmental social and medical insurance and retirement benefit plans at the statutory rates in force during the year.

In Russia, all social contributions, including contributions to the pension fund, are substituted with a unified social tax ("UST") calculated by the application of a regressive rate from 26% to 2% (from 35.6% to 2% before January 1, 2005) of the annual gross remuneration of each employee. UST is allocated to three social funds, including the pension fund, where the rate of contributions to the pension fund vary from 20% to 2% (from 28% to 2% before January 1, 2005), respectively, depending on the annual gross salary of each employee. The contributions are expensed as incurred.

The Group has historically offered its employees certain benefits upon and after retirement. The cost of such benefits is recognized during an employee's years of active service (Note 16). The Group accounts for pension plans following the requirements of SFAS No. 87, *Employers' Accounting for Pensions* ("SFAS 87") and SFAS No. 132R, *Employers' Disclosure about Pensions and Other Postretirement Benefits, an amendment of SFASB Statements No. 87, 88 and 106* ("SFAS 132R"). The plan is managed by the Pension Fund Sistema, a subsidiary of Sistema.

Call and Put Option – The Company accounts for the call and put option granted in connection with acquisition of 7.7% stake in Svyazinvest (see Note 10) in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities, as amended* ("SFAS 133"). At the grant date, the fair value of call and put option was included in cost of acquisition of Svyazinvest shares. Subsequent changes in the fair value of the call and put option are recorded
in the consolidated statement of operations. During 2006, the fair value of the call and put option increased by $60.0 million.

Income Taxes – Income taxes are computed in accordance with RF laws. Income tax rate in the RF is 24%. In July 2005, amendments to Russian income tax legislation were enacted to increase, effective January 1, 2006, the income tax rate on dividends paid within Russia to 9% (previously 6%).

Deferred income taxes are accounted for under the liability method and reflect the tax effect of all significant temporary differences between the tax basis of assets and liabilities and their reported amounts in the consolidated financial statements. A valuation allowance is provided for deferred tax assets if it is more likely than not that these items will either expire before the Group will be able to realize the benefit, or the future deductibility is uncertain.

Borrowing Costs – The Group capitalizes interest on borrowings during the active construction period of major capital projects. Capitalized interest is added to the cost of the underlying assets and is amortized over the useful lives of the assets. For the years ended December 31, 2006, 2005 and 2004 capitalized borrowing costs amounted to $0.9 million, $0.5 million, and $0.8 million, respectively. Arrangement, commission, commitment and related legal fees paid to secure a firm commitment from lenders and other direct debt issuance costs incurred in connection with new borrowings are deferred and amortized over the expected terms of the related loans using the effective interest method. Other borrowing costs are recognized as an expense in the period in which they were incurred.

Earnings Per Share – Earnings per share is computed using the two-class method. Net income available to common shareholders is divided by the weighted average number of common shares outstanding during the year. Net income available to common shareholders is determined by reducing net income by the income attributable to the holders of preferred shares (Note 22). As the Group had not issued any dilutive instruments, basic earnings per share are equal to diluted earnings per share.

Comprehensive Income – Comprehensive income is defined as net income plus all other changes in net assets from non-owner sources. The following is a reconciliation of net and comprehensive income, net of income tax effect:

	2006	**2005**	**2004**
Net income	$ 125,274	$ 161,534	$ 75,027
Other comprehensive income: translation adjustment	77,779	(32,078)	47,713
Total comprehensive income	**$ 203,053**	**$ 129,456**	**$ 122,740**

Comparative Information – Certain prior year amounts and disclosures have been reclassified to conform to the 2006 presentation. Certain particular items of cash flows were reclassified from investing activities into operating activity.

New Accounting Pronouncements – In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* – including an amendment of FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities,* which permits an entity to measure certain financial assets and financial liabilities at fair value. Statement No. 159 offers an irrevocable option to carry the vast majority of financial assets and liabilities at fair value, with changes in fair value recorded in earnings (the fair value option, or FVO). The Statement's objective is to improve financial reporting by allowing entities to mitigate volatility in reported earnings caused by the measurement of related assets and liabilities using different attributes, without having to apply complex hedge accounting provisions. Statement 159 is effective as of the beginning of an entity's first fiscal year beginning after November 15, 2007. Early adoption is permitted as of the beginning of the previous fiscal year provided that the entity (1) makes that choice in the first 120 days of that fiscal year, (2) has not yet issued financial statements, and (3) elects to apply the provisions of FASB Statement No. 157, *Fair Value Measurements*. The Company is currently evaluating the provisions of SFAS No. 159 to determine the potential impact, if any, its adoption will have on the Company's financial statements.

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, an amendment of FASB Statements No. 87, 88, 106, and 132(R)". SFAS No. 158 requires companies with publicly traded equity securities that sponsor a postretirement benefit plan to fully recognize, as an asset or liability, the overfunded or underfunded status of their benefit plan(s). The funded status is measured as the difference between the fair value of the plan's assets and its benefit obligation. SFAS No. 158 also requires companies to measure their plan assets and benefit obligations as of year-end balance sheet date. SFAS No. 158 is becoming effective for fiscal years ending after December 15, 2006; the provision to require measurement at the entity's year-end balance sheet date will be effective for fiscal years ending after December 15, 2008. The adoption of SFAS No. 158 did not have material impact on the Group's financial position or results of operations.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. The standard provides guidance for using fair value to measure assets and liabilities. The standard also responds to investors' requests for expanded information about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. The standard applies whenever other standards require (or permit) assets or liabilities to be measured at fair value. The standard does not expand the use of fair value in any new circumstances. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Early adoption is permitted. The Company is currently evaluating the provisions of SFAS No. 157 to determine the potential impact, if any, its adoption will have on the Company's financial statements.

In June 2006, the FASB issued Interpretation No. 48 ("FIN No. 48"), *Accounting for Uncertainty in Income Taxes* – an interpretation of FASB Statement No. 109. The validity of any tax position is a matter of tax law, and generally there is no controversy about recognizing the benefit of a tax position in a company's financial statements when the degree of confidence is high that the tax position will be sustained upon examination by a taxing authority. The tax law is subject to varied interpretation, and whether a tax position will ultimately be sustained may be uncertain. Under FIN No. 48, the impact of an uncertain income tax position on the income tax provision must be recognized at the largest amount that is more-likely-than-not to be sustained upon audit by the relevant taxing authority. An uncertain income tax position will not be recognized if it has less than a 50% likelihood of being sustained. FIN No. 48 also requires additional disclosures about unrecognized tax benefits associated with uncertain income tax positions and a reconciliation of the change in the unrecognized benefit. In addition, FIN No. 48 requires interest to be recognized on the full amount of deferred benefits for uncertain tax positions. An income tax penalty is recognized as an expense when the tax position does not meet the minimum statutory threshold to avoid the imposition of a penalty. FIN No. 48 removes income taxes from the scope of SFAS No. 5, *Accounting for Contingencies*, and is effective for fiscal years beginning after December 15, 2006. The Group will adopt FIN No. 48 effective January 1, 2007. The Group is currently evaluating whether FIN No. 48 will have a material impact on the Group's financial position, results of operations, or cash flow.

In March 2006, FASB issued Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations – an interpretation of FASB Statement No. 143*. This Interpretation clarifies that the term "conditional asset retirement obligation" as used in FASB Statement No. 143, *Accounting for Asset Retirement Obligations*, refers to a legal obligation to perform an asset retirement activity, in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. Uncertainty about the timing and (or) method of settlement of a conditional asset retirement obligation should be factored into the measurement of the liability when sufficient information exists to make a reasonable estimate of the fair value of the obligation. Interpretation 47 is effective for the Group beginning January 1, 2006. The adoption of Interpretation 47 did not have a material impact on the Group's financial position or results of operations.

In December 2005, issued SFAS No. 153, *Exchanges of Nonmonetary Assets*, an amendment of Accounting Principles Board ("APB") Opinion No. 29, *Accounting for Nonmonetary Transactions*. SFAS No. 153 eliminates the exception from fair value measurement for nonmonetary exchanges of similar productive assets set in the APB Opinion No. 29 and replaces it with a general exception for exchanges that do not have commercial substance. SFAS No. 153 specifies that a nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. SFAS No. 153 is effective prospectively for nonmonetary exchanges occurring after June 15, 2006. The adoption of SFAS No. 153 did not have a material impact on the Group's financial position or results of operations.

In December 2005, the FASB issued SFAS No. 123R, *Share-Based Payment* ("SFAS No. 123R"), a revision of SFAS No. 123, *Accounting for Stock-Based Compensation*. SFAS No. 123R supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees* and requires all entities to recognize compensation cost in an amount equal to the fair value of share-based payments grant-date to employees. That cost is recognized over the period during which an employee is required to provide service in exchange for an award of equity instruments. The Group adopted SFAS No. 123R for stock options received by its employees in 2006.

In October 2005, the Financial Accounting Standards Board ("FASB") issued FASB Staff Position ("FSP") FAS 13-1, *Accounting for Rental Costs Incurred during a Construction Period*. Under the provisions of FSP FAS 13-1, lessees may not capitalize rental costs incurred on building or ground operating leases during a construction period. Instead, rental costs should be expensed on a straight-line basis starting at the beginning of the lease term, i.e., when the lessee takes possession of or is given control of the leased property. The provisions of FSP FAS 13-1 are effective starting with the first reporting period beginning after December 15, 2005. The adoption of FSP FAS 13-1 did not have a material effect on the Group's financial position or results of operations.

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections*, which replaces APB Opinion No. 20, *Accounting Changes* and SFAS No. 3, *Reporting Accounting Changes in Interim Financial Statements*. SFAS No. 154 changes the requirements for the accounting and reporting of a change in accounting principle and is applicable to all voluntary changes and to changes required by an accounting pronouncement if such pronouncement does not specify transition provisions. SFAS No. 154 requires retrospective application to the prior periods' financial statements of changes in accounting principle. In cases when it is impracticable to determine the period-specific or cumulative effects of an accounting change, the statement provides that the new accounting principle should be applied as of the earliest period for which retrospective application is practicable or, if impracticable to determine the effect of a change to all prior periods, prospectively from the earliest date practicable. This Statement is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The adoption of SFAS No. 154 did not have a material impact on the Group's financial position or results of operations.

4. DISCONTINUED OPERATIONS

During 2003, the management made a decision to dispose of operations of P-Com, a subsidiary of MTU-Inform. In August 2004, MTU-Inform, then an affiliate of the Group, sold 83.25% of voting common shares of P-Com to SkyLink, an affiliate of Sistema, for the total cash consideration in amount of $16.0 million.

In accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, ("SFAS 144") in the consolidated financial statements of the Group P-Com business was classified as discontinued operations for the year ended December 31, 2004. Accordingly, the Group's share in net income and loss from disposal of P-Com have been excluded from the respective captions in the statement of operations and have been reported as gain or loss from discontinued operations, net of applicable taxes for the year ended December 31, 2004.

5. CASH AND CASH EQUIVALENTS

Cash and cash equivalents as of December 31, 2006, 2005 and 2004 consisted of the following:

	2006	2005	2004
Cash in RUB	$ 24,453	$ 19,427	$ 24,068
Cash in USD	916	1,018	919
Cash in other currencies	505	112	28
Cash equivalents	335	6,926	3,733
Total	**$ 26,209**	**$ 27,483**	**$ 28,748**

Cash and cash equivalents held by the Group with Moscow Bank for Reconstruction and Development ("MBRD"), a subsidiary of Sistema, as of December 31, 2006, 2005 and 2004 amounted to $17.2 million, $18.7 million and $14.5 million, respectively.

6. SHORT-TERM INVESTMENTS

Short-term investments as of December 31, 2006, 2005 and 2004 consisted of the following:

	2006	2005	2004
Related parties (Note 25)			
RUB-denominated notes receivable from MBRD	$ 24,711	$ -	$ -
RUB-denominated time deposits in MBRD	6,457	52,116	19,821
Comstar-Direct (former MTU-Intel) RUB-denominated promissory note	771	-	-
Other non-interest bearing loans to related parties	80	1,137	1,188
USD-denominated time deposits in MBRD	-	4,600	4,600
P-Com RUB-denominated promissory note	-	3,822	-
RUB-denominated time deposits with third party	26,205	-	-
Total	**$ 58,224**	**$ 61,675**	**$ 25,609**

RUB-denominated time deposits in MBRD bear no interest and mature in June 2007. RUB-denominated notes receivable from MBRD bear effective interest rate of 7.3% per annum and mature in June 2007.

Comstar-Direct (former MTU-Intel) promissory note was reclassified to short-term investments as of December 31, 2006 as it matures in October 2007.

Other non-interest bearing loans mature in 2007.

7. ACCOUNTS RECEIVABLE, ADVANCES AND TAXES RECEIVABLE, NET

Accounts receivable, advances and taxes receivable as of December 31, 2006, 2005 and 2004 consisted of the following:

	2006	2005	2004
Accounts receivable from subscribers	$ 48,722	$ 28,782	$ 24,624
Receivables from related parties, including affiliates and OAO Rostelecom ("Rostelecom") (Note 25)	32,651	28,725	20,738
Other receivables and advances	9,672	17,671	6,326
VAT recoverable	9,428	23,999	22,113
Other taxes receivable	12,473	2,777	3,108
Allowance for doubtful accounts	(11,479)	(4,162)	(1,586)
Total	**$ 101,467**	**$ 97,792**	**$ 75,323**

Rostelecom, a provider of national long distance and international telecommunications services, is a subsidiary of Svyazinvest, which owns 28% of MGTS voting shares. Svyazinvest is controlled by the Russian government. In December 2006, the Group and Comstar UTS acquired approximately 7.7% and 17.3% of shares in Svyazinvest, respectively (see Note 10).

Rostelecom pays a fee to MGTS for the transit of domestic long distance and international calls originated by MGTS' subscribers. Respective revenue amounts are disclosed in Note 25.

8. PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment as of December 31, 2006, 2005 and 2004 consisted of the following:

	2006	2005	2004
Buildings and site improvements	$ 329,048	$ 276,274	$ 270,281
Switches and transmission devices	1,136,530	937,786	850,088
Other fixed assets	225,023	209,797	210,540
Construction in progress	181,071	95,582	89,157
Property, plant and equipment, at cost	1,871,672	1,519,439	1,420,066
Less: Accumulated depreciation	(595,268)	(481,298)	(443,100)
Property, plant and equipment, net	**$ 1,276,404**	**$ 1,038,141**	**$ 976,966**

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

Depreciation expense for the years ended December 31, 2006, 2005 and 2004 , net of amortization of property, plant and equipment contributions (see Note 17) amounted to $97.3 million, $73.3 million and $69.7 million, respectively.

In connection with revision of estimates of analogue equipment residual lives performed by the management, effective July 1, 2006 MGTS accelerated the phasing out of such equipment.

9. INTANGIBLE ASSETS, NET

Intangible assets, net of accumulated amortization, as of December 31, 2006, 2005 and 2004 consisted of the following:

	December 31, 2006			December 31, 2005			December 31, 2004		
	Gross carrying value	Accumu-lated Amorti-zation	Net carrying value	Gross carrying value	Accumu-lated Amorti-zation	Net carrying value	Gross carrying value	Accum-ulated Amor-tization	Net carrying value
Billing systems	$ 55,726	$ (22,820)	$ 32,906	$ 35,765	$ (11,378)	$ 24,387	$ 24,541	$ (7,418)	$ 17, 123
Other software	1,920	(1,228)	692	4,184	(1,513)	2,671	3,317	(946)	2, 371
Total, net:	**$ 57,646**	**$ (24,048)**	**$ 33,598**	**$ 39,949**	**$ (12,891)**	**$ 27,058**	**$ 27,858**	**$ (8,364)**	**$ 19,494**

Amortization expense recorded on intangible assets for the years ended December 31, 2006, 2005 and 2004 amounted to $9.7 million and $4.8 million and $1.5 million, respectively. Based on the intangible assets existing at December 31, 2006, the estimated amortization expense for each of the three succeeding years is as follows:

Year ended December 31,	
2007	$ 11,559
2008	11,483
2009	10,556
Total	**$ 33,598**

Actual amortization expense to be reported in future periods can differ from these estimates as a result of new intangible assets acquisitions, changes in useful lives and other relevant factors.

10. LONG-TERM INVESTMENTS

Long-term investments as of December 31, 2006, 2005 and 2004 consisted of the following:

	2006		2005		2004	
	Ownership, %	Investment	Ownership, %	Investment	Ownership, %	Investment
Investments in affiliates:						
MTU-Inform	-	$ -	-	$ -	51	$ 95, 062
Comstar UTS	-	-	-	-	50	37, 691
Telmos	-	-	-	-	40	20,108
Comstar-Direct (former MTU-Intel)	-	-	-	-	30	6,736
Total investments in affiliates (Note 25)	-	-	-	-	-	159,597
Investments stated at cost:						
Svyazinvest, a related party (Note 25)	7.7%	427,692		-		-
Other investees, at cost	Various	7,432	Various	6,784	Various	7,090
P-Com, a subsidiary of Skylink, an affiliate of Sistema, RUB-denominated loan (Note 25)		4,178		-		3,964
Comstar-Direct (former MTU-Intel), a related party, RUB-denominated promissory note (Note 25)		-		598		526
Interest free loans to investees		1,252		115		155
Total		**$ 440,554**		**$ 7,497**		**$ 171, 332**

MGTS and its subsidiaries, MTU-Inform, Comstar UTS, Telmos, Comstar-Direct (former MTU-Intel) and their subsidiaries collectively represent the fixed line communications business of Sistema. MGTS and its subsidiaries provide the traditional fixed line communication services, while MTU-Inform, Comstar UTS, Telmos, Comstar-Direct (former MTU-Intel) and their subsidiaries provide the alternative fixed line communication services. During the years ended December 31, 2005 and 2004, Sistema performed operational merger of the entities providing the alternative communication services and consolidated its fixed line communication business under Comstar UTS ("Comstar UTS Group").

As a part of this corporate restructuring, in November 2005, Comstar UTS issued additional shares to Sistema, MGTS and their subsidiaries. These shares were exchanged for Sistema's shareholdings in MGTS, MTU-Inform, Telmos and Comstar-Direct (former MTU-Intel) and MGTS' shareholdings in MTU-Inform, Telmos and Comstar-Direct (former MTU-Intel). Upon completion of this transaction, Comstar UTS owned 55.6% of MGTS' common shares and MGTS owned 20.7% of Comstar UTS' common shares as of December 31, 2005.

In February 2006, Comstar UTS completed an initial public offering ("IPO") of 146,500,000 common shares, including 139,000,000 newly issued shares and 7,500,000 shares sold by the shareholders. The shares (in the form of global depositary receipts ("GDRs"), with one GDR representing one share) were admitted to trade on the London Stock Exchange. As a result of Comstar UTS IPO MGTS' shareholding in Comstar UTS was diluted to 13.8%.

Before November 2005, the Group accounted for its investments in MTU-Inform, Comstar UTS, Telmos and Comstar-Direct (former MTU-Intel) using the equity method. Starting from November 2005, the Group accounts for its investment in Comstar UTS with carrying value of $173.4 million as a reduction of shareholders' equity.

In December 2006, the Group acquired a 7.7% stake in Telecommunication Investment Joint Stock Company ("Svyazinvest") from Mustcom Limited for a total cash consideration of $400 million. In a series of transactions, Comstar UTS and MGTS Finance S.A. have acquired 4,879,584,306 ordinary shares of Svyazinvest representing 25% stake plus one share, with Comstar UTS buying 3,378,173,750 shares, or 17.3% of total outstanding shares of Svyazinvest, and MGTS Finance S.A. buying 1,501,410,556 shares, or 7.7% of total outstanding shares of Svyazinvest.

Simultaneously with the acquisition of the 7.7% stake in Svyazinvest, MGTS Finance S.A. and "2711 Centerville Cooperatief U.A." ("2711 UA"), an affiliate of Mustcom Limited, signed a call and put option agreement, which gives 2711 UA a right to purchase and sell 46,232,000 shares of Comstar UTS, representing 11.06% of total outstanding shares of Comstar UTS, from MGTS Finance S.A. The call option acquired by 2711 UA may be exercised at a strike price of US $6.97 per share at any time following the signing of this agreement with respect to 10.5% of Comstar UTS' shares. The call option for the remaining 0.56% stake may be exercised beginning from April 1, 2007. The call option will expire one year from the date of signing of this agreement. 2711 UA may exercise its put option within two years from the date of exercising the call option at a strike price, which will be calculated based on a weighted average price of Comstar UTS' GDRs during the period.

Fair value of the call and put option as of December 11, 2006 was estimated at $90.0 million. MGTS' share of the fair value of the call and put option as of December 11, 2006 was included in cost of investment, while Comstar UTS' share was accounted for as decrease in additional paid-in capital. The Group estimates the fair value of the respective liability using an option pricing model and re-measures it as of each balance sheet date. Respective gains and losses are included in the statement of operations for the period and amounted to $60.0 million for the year ended December 31, 2006.

The Group does not exercise significant influence over the operating and financial policies of Svyazinvest and, accordingly, accounts for its investment in Svyazinvest at cost.

In 2006, the management of Skylink started negotiations to extend timing of repayment of RUR denominated loan, which was overdue as of December 31, 2006. While the negotiations has not yet resulted in a firm repayment schedule, management believes that substantially all the amount will be paid off in 2008 or thereafter. Accordingly, as of December 31, 2006 respective amounts were re-classified to long-term investments. In December 2006, Comstar UTS received an irrevocable offer from Sistema to sell to Sistema, at book value, substantially all of the amounts receivable from P-Com, Sky-Link and MCC, including loans and notes together with accrued interest, and accounts receivable. The offer expired on February 1, 2007 and was subsequently renewed with new expiration date set as June 30, 2007.

11. RESTRICTED CASH

The Citibank credit facility requires MGTS to hold a deposit with Citibank of $2.3 million (see Note 13). In addition, MGTS signed a letter of credit with Vneshtorgbank in 2006 to purchase telecommunication equipment from STROM Telecom, a subsidiary of Sistema. The amount of a deposited cash under this letter of credit as of December 31, 2006 is $1.7 million.

12. LONG-TERM TRADE AND OTHER RECEIVABLE

In connection with the long-term program of digitalization of MGTS' network and planned renovation of certain MGTS' buildings, during the fourth quarter of 2005, MGTS has made an advance payment to the Moscow City Government, which will be offset against the future liability of MGTS to provide the Moscow City Government with its share in the buildings when their reconstruction is complete and the sales commence. Due to prolongation of certain stages of the program, as of December 31, 2006 the advance of $10.4 million was re-classified to long-term receivable.

In addition, long-term trade receivables at December 31, 2006 include $6.9 million due from MTU-Inform, a subsidiary of Comstar UTS, as the Group provided extended payment terms to MTU-Inform. The amount will be repaid in equal quarterly installments in 2008-2010.

13. DEBT

Debt obligations as of December 31, 2006, 2005 and 2004 consisted of the following:

	Currency	2006	2005	2004
Bonds 5th issue	RUB	$ 55,842	$ 52,115	$ -
Bonds 4th issue	RUB	27,533	52,115	54, 057
Bonds 3th issue	RUB	-	-	36,038
Total corporate bonds		**83,375**	**104,230**	**90,095**
Comstar UTS, related party (Note 25)	USD	401,000	-	-
Vneshtorgbank	EUR	21,428	13,107	9,908
Citibank	USD	17,117	21,227	15,144
MBRD, related party (Note 25)	EUR	2,526	-	-
Vneshtorgbank	USD	-	2,920	7,073
Sberbank	RUB	-	-	12,613
Raiffeisenbank	USD	-	-	3,750
Guta-bank	USD	-	-	773
Long-term portion of vendor financing	Various	7	2,690	9,611
Short-term portion of vendor financing	Various	4,352	8,570	16,070
Long-term portion of finance leases	Various	16,224	28,665	19,247
Short-term portion of finance leases	Various	12,910	12,345	5,276
Total debt		**558,939**	**193,754**	**189,560**
Less amounts maturing within one year		(112,063)	(83,123)	(72,278)
Total long-term debt		**$ 446,876**	**$ 110,631**	**$ 117,282**

Corporate Bonds – In May 2005, MGTS issued 5-year RUB-denominated bonds (fifth issue) with a face value of RUB 1,500 million (equivalent to $57.0 million as of December 31, 2006). The bonds carry a coupon of 8.3% per annum during the two years ending April 2007. In June 2006, Petrodvor repurchased the bonds at par value for the amount of $0.6 million. In May 2007, at management discretion, MGTS will re-determine the interest rate on the fifth issue of bonds.

In April 2004, MGTS issued 5-year RUB-denominated bonds (fourth issue) with the face value of RUB 1,500 million (equivalent to $57.0 million as of December 31, 2006). The bonds carried a coupon of 10.0% per annum, which was decreased to 7.1% per annum in April 2006. MGTS made an unconditional offer to repurchase the bonds at par value in April 2006, which was exercised in the amount of approximately $30.1 million. In April 2007, at management discretion, MGTS decided to keep the interest rate on the fourth issue of bonds at the same level of 7.1%. Next time the interest rate will be re-determined in April 2008.

In February 2003, MGTS issued 2-year RUB-denominated bonds (third issue) with the face value of 1,000 million RUB (equivalent of $38.0 million as of December 31, 2006) due in 2005. The bonds carried a coupon of 12.3% during the first year of trading and of 17.0% during the second year. In February 2005, MGTS has fully repaid the third issue of the bonds.

As of December 31, 2006, the fair value of the bonds was approximately $83.7 million.

Currently, MGTS has an unconditional outstanding offer to repurchase the fourth and the fifth issues of the bonds at par in April and May 2007, respectively. Accordingly, both issues are classified as current liability in the accompanying consolidated balance sheet as of December 31, 2006.

Citibank – During the years ended December 31, 2006, 2005, 2004 and 2003, MGTS entered into four credit facilities with Citibank for a total amount of $25.0 million. All facilities bear interest of LIBOR+1.6% (equivalent of 6.96% per annum as of December 31, 2006) and are repayable in 8 semi-annual installments every six months with the last payments in 2008-2010. The facilities were opened to finance acquisitions of equipment from STROM telecom, a subsidiary of Sistema. The facilities are collaterized by equipment with approximate carrying amount of $16.9 million, a deposit of $2.3 million in Citibank (see Note 11) and are guaranteed by Export Guarantee and Insurance Corporation of the Czech Republic. As of December 31, 2006, the amount outstanding under these facilities was $17.1 million. The credit facilities also require MGTS to meet various financial and non-financial covenants. As of December 31, 2006, MGTS was required to get consent of Citibank prior to raising additional finance facility in excess of $ 30.0 million and a restriction was set for total debt which should not exceed $250.0 million. In addition, debt to earnings before interest, depreciation and tax ratio should not exceed 1:1.

Vneshtorgbank – In January 2006, MGTS entered into a credit agreement with Vneshtorgbank for an amount of EUR 7.7 million (equivalent of $10.1 million as of December 31, 2006) to finance acquisition of equipment. The loan matures in January 2012 and bears interest at Euribor+5% per annum (equivalent of 8.73% per annum as of December 31, 2006). Equipment with approximate carrying value of $9.2 million is pledged to collateralize the outstanding balance under the agreement. As of December 31, 2006, the amount outstanding under the agreement was $10.2 million.

In March 2005, MGTS entered into a credit agreement with Vneshtorgbank for an amount of EUR 5.3 million (equivalent of $7.0 million as of December 31, 2006) to finance acquisition of equipment. The loan matures in September 2010 and bears interest at Euribor+5.0% per annum (equivalent of 8.73% per annum as of December 31, 2006). Equipment with approximate carrying value of $6.2 million is pledged to collateralize the outstanding balance under the agreement. As of December 31, 2006, the amount outstanding under the agreement was $5.5 million.

In July 2004, MGTS entered into two credit agreements with Vneshtorgbank for a total amount of EUR 7.3 million (equivalent of $9.6 million as of December 31, 2006) to finance acquisition of equipment. The loans mature in January 2010 and bear interest at the highest of Euribor+5.35% (equivalent of 9.2% per annum as of December 31, 2006) or 7.5%. Equipment with approximate carrying amount of $7.8 million is pledged to collateralize the outstanding balance under the agreement. As of December 31, 2006, the amount outstanding under this credit agreement was $5.7 million.

In 2002, the Group received a number of loans from Vneshtorgbank maturing in 2005-2006 to finance working capital. As of December 31, 2006 these loans were repaid.

MBRD – In July 2006, MGTS entered into a credit agreement with MBRR for an amount of EUR 2.1 million (equivalent of $2.8 million as of December 31, 2006) to finance acquisition of equipment. The loan is repayable in equal semi-annual installments in 2006-2011 and bears interest at Euribor +2.75% per annum (equivalent of 6.33% per annum as of December 31, 2006). As of December 31, 2006, the amount outstanding under the agreement was $2.5 million.

Vendor Financing – Foreign suppliers of telecommunications equipment provide uncollateralized commercial credit to the Group denominated in various currencies on short-term and long-term bases, mostly interest free. The present value of the obligations under vendor financing agreements was determined using the Group's incremental borrowing rate prevailing at the date of transaction.

Finance (capital) Leases – During 2001-2006, MGTS entered several lease agreements for telecommunications equipment. The agreements expire in 2006-2009 and assume transfer of ownership for equipment to MGTS after the last lease payment is made. The net book value of leased assets comprised $64.3 million, $62.7 million and $38.6 million as of December 31, 2006, 2005 and 2004, respectively, while interest expense for the years ended December 31, 2006, 2005 and 2004 amounted to $3.3 million, $2.5 million and $1.9 million, respectively. Depreciation charge on leased assets for the year ended December 31, 2006, 2005 and 2004 amounted to $4.1 million, $2.7 million and $1.8 million, respectively.

The following table presents future minimum lease payments under finance leases together with the present value of the net minimum lease payments as of December 31, 2006:

Payments due in the year ended December 31,		
2007	$	15,137
2008		11,734
2009		5,686
Total minimum lease payments (undiscounted)	$	32,557
Less: amount representing interest		(3,423)
Present value of net minimum lease payments	$	29,134
Less: current portion of lease obligations		(12,910)
Non-current portion of lease obligations	**$**	**16,224**

The weighted average interest rate of all borrowings denominated in currencies other than the Ruble at December 31, 2006, 2005 and 2004 was 7.5%, 7.1% and 6.6%, respectively, while it was 7.9%, 9.2% and 12.6%, respectively, for borrowings denominated in RUB. These figures are calculated without taking into account borrowings from related parties, vendor financing arrangements and capital lease agreements.
The debt obligations as of December 31, 2006 have the following maturities:

2007	$	112,063
2008		23,190
2009		416,380
2010		3,972
2011		2,316
Thereafter		1,018
Total	**$**	**558,939**

14. ACCOUNTS PAYABLE, TAXES PAYABLE AND ACCRUED LIABILITIES

Accounts payable, taxes payable and accrued liabilities as of December 31, 2006, 2005 and 2004 consisted of the following:

	2006	2005	2004
Trade accounts payable	$ 14,776	$ 7,961	$ 7,137
Accounts payable to related parties	13,380	21,651	2,027
Accrued payroll	12,537	9,377	8,061
Taxes payable	8,537	13,261	13,174
Accrued interest	2,028	1,561	3,591
Other liabilities	13,864	2,645	5,743
Total	**$ 65,122**	**$ 56,456**	**$ 39,733**

Related party balances as of December 31, 2006, 2005 and 2004 are disclosed in Note 25.

15. DEFERRED REVENUE

Deferred revenue as of December 31, 2006, 2005 and 2004 consisted of the following:

	2006	2005	2004
Short-term portion			
Deferred connection fees	$ 35,026	$ 30,968	$ 27,588
Advances from customers	15,058	16,996	19,017
Total	**$ 50,084**	**$ 47,964**	**$ 46,605**
Long-term portion			
Deferred connection fees	$ 114,845	$ 109,958	$ 97,538
Total	**$ 114,845**	**$ 109,958**	**$ 97,538**

16. RETIREMENT AND POST-RETIREMENT BENEFITS

MGTS has historically provided certain benefits to employees upon their retirement and afterwards. Currently, the main features under the defined benefit pension program include the following:

Monthly regular pension – Employees retiring with at least fifteen years of service receive lifetime payments varying from RUB 3,600 (equivalent of USD 137 as of December 31, 2006) to RUB 50,400 (equivalent of USD 1,914 as of December 31, 2006) per year depending on employee's actual years of service and qualification;

Death-in-service – Lump-sum payment of RUB 15,000 (equivalent of USD 570 as of December 31, 2006), payable upon death of an employee, irrespective of past service;

Lump-sum upon retirement – Lump-sum payment upon retirement of employees with at least five years of service varying from RUB 3,700 (equivalent of USD 141 as of December 31, 2006) to RUB 22,200 (equivalent of USD 843 as of December 31, 2006) depending on employee's actual years of service;

Monthly telephone subsidy – Qualifying pensioners (those who served more than 30 years at MGTS) get 50% subsidy (approximately USD 3.8 per month as of December 31, 2006) for their monthly telephone bills from MGTS;

Death-while-pensioner – MGTS pays lump-sum benefits to relatives of deceased pensioners of up to RUB 10,000 (equivalent of USD 380 as of December 31, 2006).

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

Discount rate	6.5%
Future salary increases	6.5%
Future pension increases	0.0%
Average life expectancy of members from date of retirement	17 years

The change in the projected benefit obligation and the change in plan assets are presented in the following table:

	2006	2005	2004
Change in projected benefit obligation			
Projected benefit obligation, beginning of the year	$ 18,868	$ 13,550	$ 6,034
Service cost	(8,538)	2,914	1,601
Interest cost	1,232	1,441	634
Plan amendments	-	-	4,488
Actuarial losses	6,352	2,118	855
Benefit payments	(365)	(668)	(433)
Currency translation effect	(1,607)	(487)	371
Projected benefit obligation, end of the year	15,942	18,868	13,550
Change in fair value of plan asset			
Fair value of plan asset, beginning of the year	2,651	2,037	1,137
Actual return on plan assets	338	668	433
Employer contributions	3,137	614	900
Benefits paid	(365)	(668)	(433)
Fair value of plan assets, end of the year	5,761	2,651	2,037
Unfunded status of the plan, end of the year, net	**$ 10,181**	**$ 16,217**	**$ 11,513**

Service cost in the year ended December 31, 2006 represents benefit and relates primarily to decrease in the number of employees and reduction of average age of Group' employees.

The increase in projected benefit obligation due to plan amendment in the year ended December 31, 2004 relates to the increase in the base rate used to determine the monthly payments to the retired employees. The changes in the projected benefit obligation due to actuarial losses for the years ended December 31, 2006, 2005 and 2004 relate primarily to the changes in the discount rate and employees turnover assumptions.

The accumulated benefit obligation as of December 31, 2006, 2005 and 2004 was $15.9 million, $18.9 million and $13.6 million, respectively.

The components of the net periodic benefit costs for the years ended December 31, 2006, 2005 and 2004 are as follows:

	2006	2005	2004
Service cost	$ (8,538)	$ 2,914	$ 1,601
Interest cost	1,232	1,441	634
Net periodic benefit cost	**$ (7,306)**	**$ 4,355**	**$ 2,235**

The Group's management expects contributions to the plan during the year ended December 31, 2007 to amount to $1.1 million.

The future benefit payments to retirees under the defined benefit plan are expected as follows:

Year ended December 31,		
2007	$	3,737
2008		1,441
2009		1,390
2010		1,343
2011		1,300
2012-2016		4,867
Total	**$**	**14,078**

17. PROPERTY, PLANT AND EQUIPMENT CONTRIBUTIONS

The Group receives telecommunication infrastructure which is intended to operate as an integral part of the Moscow city wire line network from the real estate constructors free of charge as provided by the regulations of the city government. Property, plant and equipment contributions received by the Group during the years ended December 31, 2006, 2005 and 2004 were as follows:

	2006	2005	2004
Property, plant and equipment at the beginning of the year	$ 102,746	$ 103,822	$ 88,388
Contributions received during the year	5,169	6,268	13,597
Currency translation effect	9,566	(3,729)	4,993
	117,481	106,361	106,978
Deferred revenue amortized	(4,127)	(3,615)	(3,156)
Property, plant and equipment contributions at the end of the year	**$ 113,354**	**$ 102,746**	**$ 103,822**

18. INCOME TAXES

The Group's provision for income tax for the years ended December 31, 2006, 2005 and 2004 is as follows:

	2006	2005	2004
Current income tax	$ 59,124	$ 45,739	$ 23,552
Deferred income tax (benefit)	5,840	(2,477)	3,070
Total income tax expense	**$ 64,964**	**$ 43,262**	**$ 26,622**

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

	2006	2005	2004
Income tax charge computed on income before taxes at standard tax rate applicable to the Group of 24%	$ 45,552	$ 44,106	$ 20,481
Income tax charge on income from affiliates	-	1,892	1,452
Effect of change in income tax rate attributable to income from affiliates	-	-	2,076
Non-deductible expenses and other items	5,683	2,340	2,835
Non-taxable income	(671)	(5,076)	(222)
Call and put option	14,400	-	-
Income tax expense	**$ 64,964**	**$ 43,262**	**$ 26,622**

Temporary differences between the tax and accounting bases of assets and liabilities give rise to the following deferred tax assets and liabilities at December 31, 2006 and 2005:

	2006	2005	2004
Deferred tax assets			
Accrued operating expenses	$ 16,335	$ 4,295	$ 1,722
Post-retirement benefits	2,444	3,892	2,763
Property, plant and equipment contributions	27,205	24,659	24,917
Deferred revenues	36,203	33,822	30,031
Allowance for doubtful accounts	-	429	3,617
Total	**$ 82,187**	**$ 67,097**	**$ 63,050**
Deferred tax liabilities			
Undistributed earnings of affiliates	$ (9,241)	$ (9,337)	$ (8,338)
Depreciation of property, plant and equipment	(86,532)	(65,203)	(65,139)
Allowance for doubtful accounts	(779)	-	-
Other	(139)	(318)	(240)
Total	**$ (96,691)**	**$ (74,858)**	**$ (73,717)**
Net deferred tax assets, current portion	14,845	9,562	11,432
Net deferred tax liabilities, long-term portion	(29,349)	(17,323)	(22,099)

19. SHAREHOLDERS' EQUITY

Common shares carry voting rights with no guarantee of dividends. Preferred shares carry guaranteed non-cumulative dividend rights amounting to the higher of (a) 10% of standalone net income of MGTS as determined under Russian accounting regulations and (b) the dividends paid on common shares. No dividends may be declared on common shares before dividends on preferred shares are declared. Where the preferred dividend is not paid in any year the preferred shares become voting at par with common shares. At the annual shareholders meeting in June 2006, no dividend for the year ended December 31, 2005 was approved (see also Note 26).

Preferred shares carry no voting rights except on resolutions regarding liquidation or reorganization of MGTS, changes to dividend levels of preferred shares, or the issuance of additional preferred stock, or when no preferred dividend is paid as discussed above. Such resolutions require two-thirds approval of preferred shareholders. The preferred shares have no rights of redemption. In the event of liquidation, preferred shares have priority over common shares. In this circumstance, holders of preferred shares receive the par value of their shares, or the amounts payable to common shareholders, if higher.

In accordance with the Charter, MGTS may, at its own discretion, repurchase on the open market up to 10% of its common and preferred shares each year. Repurchased shares must either be sold or cancelled within one year of being purchased.

The distributable earnings of MGTS as of December 31, 2006, as determined under Russian accounting regulations amounted to approximately 6,349 million RUB (equivalent of $233.5 million as of December 31, 2006).

20. OPERATING REVENUES

Operating revenues for the years ended December 31, 2006, 2005 and 2004 consisted of the following:

	2006	2005	2004
Residential			
Voice	$ 319,454	$ 226,840	$ 156,094
Payphones	1,640	4,620	10,347
Additional telecommunication services	10,558	9,230	5,268
Other	2,965	2,502	2,061
Corporate			
Voice	$ 146,348	$ 129,153	$ 125,403
Access node and trunks rental	50,853	33,678	19,215
Additional telecommunication services	14,412	12,428	9,907
Other	11,448	12,112	4,840
Operators	244,490	209,061	147,712
Total	**$ 802,168**	**$ 639,624**	**$ 480,847**

Additional revenue received in 2006 for CPP traffic amounted to $32.9 million.

21. OPERATING EXPENSES, NET

Operating expenses for the years ended December 31, 2006, 2005 and 2004 consisted of the following:

	2006	2005	2004
Employee costs	$ 198,093	$ 177,303	$ 154,567
Depreciation and amortization	103,035	74,496	68,011
Repairs and maintenance	61,910	63,658	59,943
Network traffic	38,711	759	41
Taxes other than income taxes	23,232	21,048	26,002
Utilities and energy	18,082	16,714	15,246
Rent	15,375	13,571	10,573
Security	18,878	11,745	7,785
Bank charges	11,881	10,003	8,687
Consulting and audit	10,902	7,282	1,811
Advertising and marketing	6,841	2,990	3,008
Allowance for doubtful accounts and other allowances	7,461	3,326	(500)
Transportation	6,385	3,914	2,711
Universal service charge	6,189	4,006	-
Insurance	4,484	6,845	6,306
Gain on disposal of long term investments	-	(1,954)	-
Other expenses, net	17,731	29,724	17,146
Total	**$ 549,190**	**$ 445,430**	**$ 381,337**

22. COMSTAR UTS STOCK OPTION PLAN

On September 15, 2006, the Extraordinary General Meeting of shareholders of Comstar UTS approved the stock option and stock bonus program ("the Program") for the Board of Directors and senior management of Comstar UTS and its subsidiaries. The Program is being implemented based on separate decisions of the Board of Directors.

In November 2006, Comstar UTS' board of directors approved the grant of options to certain members of senior management of MGTS. The exercise price for these options is 122 Rubles, or approximately US $4.6 per share. These stock options vest in November 2008.

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

Risk-free interest rate	4.82%
Expected option life (years)	2
Expected dividend yield	Nil
Expected volatility	38.4%
Grant date fair value of options (per share)	$6.28

Estimated volatilities are based on historical volatility of Comstar UTS' stock.

The following table summarizes information about non-vested common stock options during the year ended December 31, 2006:

	Quantity	**Exercise price, US $**
Non-vested as of December 31, 2005	-	-
Granted	417,940	4.6
Vested	-	-
Forfeited	-	-
Non-vested as of December 31, 2006	417,940	4.6

The costs recognized in accordance with stock option plan for the year ended December 31, 2006 approximated $0.08 million and were included in operating expenses in the accompanying consolidated statement of operations. Total compensation cost related to non-vested awards not yet recognized as of December 31, 2006 amounted to $1.2 million. This cost will be recognized over the 22.5 months ending November 2008.

23. EARNINGS PER SHARE

Earnings per common share have been calculated using the two-class method on the basis of income available for common shareholders, calculated as follows:

	2006	**2005**	**2004**
Net income from continuing operations	$ 125,274	$ 161,534	$ 74,848
Gain from discontinued operations	-	-	179
Less: income attributable to preferred shares	(20,879)	(26,922)	(12,505)
Net income available to common shareholders	**$ 104,395**	**$ 134,612**	**$ 62,522**

If the Group has elected to distribute the total amount of net income for the periods presented, the preferred shareholders of MGTS would be entitled to dividend payments of not less than the per share dividend received by the common shareholders (Note 19). The Group uses this assumption in calculation of earnings per share.

Weighted average number of common shares outstanding was 79,829,200 for the years ended December 31, 2006, 2005 and 2004.

24. OPERATING LEASES

(a) As lessor – The Group leases excess office space through operating leases, the majority of which are cancelable. Assets under operating leases are included in property, plant and equipment. The amount of rent income under these agreements is not significant to the Group's results.

(b) As lessee – The land on which the Group's buildings and other facilities are located is owned by the City of Moscow. The Group pays the city rent for the land based on the total area and location of land occupied. Land rental expenses were approximately \$3.5 million, \$3.2 million and \$2.9 million for each of the years ended December 31, 2006, 2005 and 2004, respectively.

The Group leases buildings, office premises, bridgeworks and collectors mainly from Moscow Government through contracts, which expire in 1 to 20 years. Rental expenses under operating leases are included in the statements of operations (Note 21).

Future minimum lease payments due under non-cancelable leases at December 31, 2006 are:

2007	$	14,084
2008		18,925
2009		24,542
2010		35,182
2011		49,230
Thereafter		136,880
Total	**$**	**278,843**

25. RELATED PARTIES

Related party balances as of December 31, 2006, 2005 and 2004 comprised of the following:

		2006		2005		2004
Accounts receivable						
Comstar UTS Group	$	17,412	$	19,318	$	10,489
Rostelecom		11,188		3,036		3,910
Mobile TeleSystems		1,692		831		667
Central Telegraph		846		1,319		1,822
Rosno		414		878		3,301
Other		1,099		3,343		549
Total accounts receivable from related parties	**$**	**32,651**	**$**	**28,725**	**$**	**20,738**
Long term accounts receivable from related parties – Comstar UTS Group (Note 12)	$	6,923		-		-

		2006		2005		2004
Accounts payable						
STROM telecom	$	6,612	$	1,232	$	1,635
Mobile TeleSystems		4,115		84		35
Central Telegraph		1,059		4		-
Sitronics Telecom Solutions (former Mediatel)		1,042		5,711		-
Sistema Hals		371		14,511		-
Other		181		109		357
Total accounts payable to related parties	**$**	**13,380**	**$**	**21,651**	**$**	**2,027**
Long term accounts payable to related parties – Sistema Hals (Note 2)	$	8,066		-		-

The Group provides communication services and rents premises to subsidiaries and affiliates of Sistema and Svyazinvest. The following table summarizes revenues received from related parties during the years ended December 31, 2006, 2005 and 2004:

		2006		2005		2004
Communication services						
Comstar UTS Group	$	102,629	$	95,145	$	55,635
Central Telegraph		12,014		9,336		14,309
Mobile TeleSystems		11,883		6,855		5,165
Rent of premises						
Comstar UTS Group	$	1,186	$	1,262	$	8,137
Mobile TeleSystems		1,946		1,291		1,142

Effective July 1, 2006, under the CPP Rules, all incoming calls on fixed and mobile lines in Russia became free of charge, and only the fixed-line or mobile operators originating the call may charge the subscriber for the call. The Group received additional revenue and incurred additional traffic costs through transactions with the following related parties in connection with CPP traffic.

		2006
MTT	$	11,422
Mobile TeleSystems		7,627
Rostelecom		4,321
Cost of CPP traffic	**$**	**23,370**

Rostelecom

MGTS does not provide domestic long-distance and international long-distance, or DLD/ILD, telecommunications services directly to its subscribers, but must route such traffic through a DLD/ILD licensed operator. In 2006, 2005 and 2004, the MGTS routed domestic long-distance and international long-distance traffic originated by its subscribers through Rostelecom. Pursuant to agreements with Rostelecom, MGTS received $22.9 million, $23.5 million and $25.9 million for DLD/ILD services, $2.5 million, $2,2 million and $1.8 million for rental of telecommunication equipment and $3.7 million, $3.6 million and $2.8 million for other services for the years ended December 31, 2006, 2005 and 2004, respectively. In 2006, 2005 and 2004, the Group also purchased services from Rostelecom, including interconnection services, amounting to $8.2 million, $1.8 million and $1.3 million, respectively. In addition, due to introduction of CPP MGTS received $6.5 million as traffic fees in 2006. As of December 31, 2006, allowance on uncollectible receivable of $5.5 million was recorded (Note 26).

Invest-Svyaz-Holding

In 2005 and 2004, the Group entered into agreements with Invest-Svyaz-Holding, a subsidiary of Sistema, for leasing of network equipment and billing system. These leases were recorded as capital leases based on the requirements of SSFAS No. 13, “Accounting for Leases.” The present value of future lease payments is reflected as a liability in the accompanying consolidated balance sheet. Amounts due within one year are classified as current liabilities, and the remaining balance as long-term liabilities. The net book value of assets leased under such agreements as of December 31, 2006, 2005 and 2004 was $54.1 million, $52.2 million and $26.1 million, respectively. The interest rate implicit in the leases varies from 10% to 14%.

The following table summarizes the future minimum lease payments under capital leases to Invest-Svyaz-Holding together with the present value of the net minimum lease payments as of December 31, 2006.

Payments due in the year ended December 31,		
2007	$	15,137
2008		11,734
2009		5,686
2010		-
Total minimum lease payments (undiscounted)		32,557
Less: amount representing interest		(3,423)
Present value of net minimum lease payments		29,134
Less: current portion of lease obligations		(12,910)
Non-current portion of lease obligations	**$**	**16,224**

For the years ended December 31, 2006, 2005 and 2004, the Group paid to Invest-Svayz-Holding $11.9 million, and $9.7 million and $4.8 million, respectively, in principal and $3.3 million, $2.5 million and $1.7 million, respectively, in interest. In addition, the Group provides guarantees to Commerzbank (Eurasia) and Komercni banka, a.s., Prague under Invest-Svyaz-Holding credit facilities, see Note 26.

Rosno

The Group purchases insurance services from Rosno, a subsidiary of Sistema until March 2007. The insurance expenses in 2006, 2005 and 2004 amounted to $4.4 million, $7.2 million and $6.1 million, respectively. The amount of prepaid insurance as of December 31, 2006, 2005 and 2004 was $0.4 million, $0.8 million and $3.3 million, respectively.

STROM telecom

The Group purchases telecommunications equipment and software from STROM telecom, a subsidiary of Sistema. The cost of equipment and software purchased from STROM telecom in 2006, 2005 and 2004 was $ 8.9 million, $. 8.5 million, and $ 10.8 million, respectively.

Central Telegraph

The Group purchased telecommunications equipment from Central Telegraph, a subsidiary of Svyazinvest. The cost of equipment purchased from Central Telegraph in 2004 was $6.4 million. In addition, during the year ended December 31, 2006, in connection with new regulations on telecommunications which came in effect in 2006, MGTS' revenue from Central Telegraph for incoming traffic and costs for outgoing traffic amounted to $12.0 million and $3.8 million, respectively.

Sitronics Telecom Solutions (former Mediatel)

The Group purchases telecommunication equipment and repair and technical maintenance services from Sitronics Telecom Solutions (former Mediatel), a subsidiary of PJSC Sitronics. The cost of equipment and services purchased in 2006, 2005 and 2004 was $14.6 million, $ 14.0 million and $ 3.4 million, respectively.

Sistema Hals

As described in Note 2, MGTS entered into a series of agreements with Sistema Hals, a subsidiary of Sistema, on project development and reconstruction of buildings of automatic telephone exchanges. During the year ended December 31, 2006, as a result of the work performed by Sistema Hals under these contracts MGTS made an accrual of $8.0 million of non-current payable to Sistema Hals. In addition MGTS owes Sistema Hals $0.4 million for construction works.

MBRD

During the years ended December 31, 2006, 2005 and 2004 the Group kept certain bank and deposit accounts and acquired promissory notes from MBRD, a subsidiary of Sistema. Interest income received from MBRD on bank and deposit accounts during the years ended December 31, 2006, 2005 and 2004 amounted to $4.9 million, $2.5 million and $2.4 million, respectively.

26. COMMITMENTS AND CONTINGENCIES

Issued Guarantees – In December 2004, MGTS became a guarantor under the credit facility between Sistema Hals and West LB Vostok Bank. The loan of $10.4 million was fully repaid in March 2006.

MGTS is a guarantor under several credit facilities between Commerzbank (Eurasia) and Invest-Svyaz-Holding. The credit facilities mature in 2007-2008. The guarantees amounted to $15.0 million as of December 31, 2006.

In 2006, MGTS became a guarantor under a credit facility provided to Invest-Svyaz-Holding by Komercni banka, a.s., Prague. The credit line for the total amount of EUR 10.4 million matures in April 2011. MGTS' guarantee amounted to $13.7 million as of December 31, 2006.

In 2006, MGTS became a guarantor under a credit facility provided to MBRD by Bankgesellschaft Berlin AG, Berlin. The credit line for the total amount of EUR 2.1 million matures in June 2011. MGTS' guarantee amounted to $2.5 million as of December 31, 2006.

Under these guarantees the Group could be potentially liable for a maximum amount of $31.2 million in case of borrower's default under the obligations. As of December 31, 2006 the Group's guarantee amounted to $31.2 million, no event of default has occurred under any of the guarantees issued by the Group.

The Group does not recognize a liability at inception for the fair value of the guarantor's obligation as provisions of SFAS Interpretation No. 45 do not apply to the guarantees issued between corporations under common control.

Russian Environment and Current Economic Situation – Over the past decade Russia has undergone substantial political and social changes. As an emerging market, Russia does not possess a fully developed business and regulatory infrastructure that would generally exist in a more mature market economy. The current government is attempting to address these issues; however it has not yet fully implemented the reforms necessary to create banking and judicial systems that usually exist in more developed markets. As a result, operations in Russia involve risks that typically do not exist in more developed markets.

Regulations on Telecommunications – On January 1, 2004, a new Law on Telecommunications came into effect in Russia. The law sets the legal basis for the telecommunications business in Russia and defines the status that state bodies have in the telecommunications sector.

The Russian government has issued several implementing acts under the Law on Communications, such as Resolution No. 87, dated February 18, 2005, approving the list of the types of licensed telecommunication activities, and Resolution No. 68, dated February 11, 2005, regarding the rules applicable to the state registration of telecommunication infrastructure such as real property. However, it is presently not yet clear how these regulations would be implemented. Thus, the uncertainty related to the Law on Communications continues.

On March 4, 2006, the Russian President approved amendments to the Telecommunications Law that introduced the Calling Party Pays rules ("CPP Rules"). Effective July 1, 2006, under the CPP

Rules, all incoming calls on fixed and mobile lines in Russia became free of charge, and only the fixed-line or mobile operators originating the call may charge the subscriber for the call. The CPP Rules primarily impacted the fixed-to-mobile calls, as fixed-line operators traditionally did not charge any fee for outgoing calls to mobile lines in Russia. Management estimates that as a result of introduction of CPP Rules, for the year ended December 31, 2006 the Group received additional revenue and incurred additional traffic costs of approximately $32.9 million and $24.7 million, respectively.

In March 2006, Russian telecommunication authorities included Comstar UTS and MGTS into the register of operators occupying a "substantial position" in the market. Connection and traffic transmission tariffs that such operators may charge other operators are regulated by the government. Tariffs are set at the economically justified levels based on actual costs for interconnection provided by operators.

According to the new Law on Telecommunications, and effective as of January 1, 2005, all subscribers are required to pay the full price for residential service, and those entitled to discounts are to receive reimbursement from the government rather than discounts from MGTS.

The Law on Telecommunications introduces a Universal Service Fund ("USF") which resulted in higher costs for all operators, including the Group. The USF is designed to fund socially important but economically unviable projects. In April 2005, Russian government approved several provisions clarifying how the USF will be collected and administered. Starting May 1, 2005, the amount of the universal service charge is 1.2% of the total revenues received from the usage of public telecommunication network less connection fees and revenues received from interconnection services provided to other operators. For the years ended December 31, 2006, 2005 and 2004 the related expense of $6.2 million, $4.0 million and nil was recorded in operating expenses.

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

Generally, tax declarations remain open and subject to inspection for a period of three years following the tax year.

Russian tax legislation is subject to varying interpretations with changes occurring frequently. As a result, transactions may be challenged by tax authorities and MGTS may be assessed additional taxes, penalties and interest, which can be significant. The periods remain open to review by the tax and customs authorities with respect to tax liabilities for three years.

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

Management believes that it has adequately provided for tax liabilities in the accompanying consolidated financial statements; however, the risk remains that relevant authorities could take differing positions with regard to interpretive issues.

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

During the 2005 and 2006, MGTS filed several claims in the Moscow Arbitration Court against the Ministry of Labor and Social Development of the Russian Federation for the recovery of losses it incurred in connection with the provision of communications services in 2003 to 2004 to Russian veterans at a reduced rate. Pursuant to the Federal Law on Veterans, MGTS is seeking full reimbursement from federal funds totaling approximately $62.1 million. In the second half of 2005, the Arbitration Court ruled in favor of MGTS for the full amount. During the year ended December 31, 2006, MGTS received a part of the compensation from the budget in the amount of $26.1 million. This amount was recorded as revenues in the accompanying consolidated statement of operations for the year ended December 31, 2006. The Company's right to any remaining reimbursement, which management estimates as approximately 957.0 million rubles ($36.3 million) as of December 31, 2006, is not reflected in the accompanying consolidated financial statements as accounts receivable or otherwise due to the uncertainty of collection.

During second half of 2006 holders of preferred shares of MGTS filed a lawsuit against MGTS, requesting to abolish MGTS' decision not to distribute dividends on preferred shares for 2005. During 2006, the court of first instance and the court of appeals ruled in favor of MGTS. In February 2007 Moscow Federal Arbitration Court returned three out of eight cases to the court of first instance for the re-trial, directing to reconsider the decision. Management believes that the Group has sustainable position in defending the case and MGTS had not declared or paid any dividends for 2005 in accordance with its Charter and relevant legislation and therefore will prevail in the proceedings, however, should the holders of the preferred shares win the case against the Group we will be liable to pay dividends for 2005 on our preferred shares and the amount of such payment may be significant (879.0 million RUB or $33.4 million).

During the 2006 and January 2007 Rostelecom filed claims in the Moscow Arbitration Court against MGTS for the disputed interconnection fees from ILD/DLD traffic generated by MGTS subscribers and local traffic fees from calls generated by other operators and transferred via Rostelecom. The disputed revenues of MGTS from Rostelecom amount to $5.5 million for the first half of 2006 and was recognized as revenues since it was believed that the amount will be paid by Rostelecom. In second half 2006 the Arbitration Court ruled in favor of Rostelecom and therefore no revenue is recognized in relation to disputed traffic in the second half of 2006 and allowance on uncollectible receivable of $5.5 million without VAT is recorded as of December 31, 2006.

Licenses – Substantially all the Group's revenues are derived from operations conducted pursuant to licenses to operate in Moscow and the Moscow region granted by the Russian Government. The voice phone communication license expires in December 2013. Suspension or termination of the Group's main license or any failure to renew it could have a material adverse effect on the financial position and operations of the Group. However, the Group has no reason to believe that the license will not be renewed, or suspended, or terminated, and the management estimates the possibility of such events as remote.

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

27. SUBSEQUENT EVENTS

In January 2007, the Company became a guarantor under a credit facility provided to Invest-Svyaz-Holding by Komercni banka, a.s., Prague. The credit line for the total amount of EUR 5.6 million (equivalent of $ 7.4 million as of December 31, 2006) matures in 2010.

In February 2007 MGTS sold its 100% subsidiary OOO "Pansion Trust" to OOO "Trans-Auto" for cash consideration in amount of approximately USD 96 thousand.

In March 2007 MGTS and ZAO "Sitronix Telecom Solutions" signed a framework agreement on purchase of NGN solution based on TENNET platform. TENNET platform implementation will allow MGTS expanding range of services offered to subscribers and provide full interaction with other operators' networks.

During April and May 2007 MGTS received compensation from the RF budget related to reimbursement for discounts granted before January 1, 2005 to certain categories of residential subscribers on installation and monthly fees amounting to 568.6 million Rubles (approximately $22.0 million as of the date of cash collection).

In May 2007, at management discretion, MGTS decided to decrease the interest rate on fifth issue of bonds to 7.1% per annum. Next time the interest rate on fifth issue of bonds will be re-determined in May 2008.

In May 2007, certain minority shareholder won the case against MGTS in respect of non-payment of dividend on preferred shares for 2005 (see Note 26) in the court of first instance, and the court determined such decision of MGTS' general shareholders' meeting in respect of dividends for 2005 null and void. MGTS will appeal this decision and management believes that the risk of ultimate negative outcome of this case to the MGTS is remote.

In May 2007, the Board of Directors of MGTS recommended an annual dividend of approximately 1.3 billion Rubles (approximately $51.5 million as of the date of announcement), or 8.75 Rubles (approximately 0.34 US dollars as of the date of the announcement) per ordinary share and 39.77 Rubles (approximately 1.54 US dollars as of the date of the announcement) per preferred share. The dividend is subject to approval by annual general meeting of Company's shareholders which was scheduled for June 29, 2007 and is to be paid by the end of 2007.