

Open Joint Stock Company “VolgaTelecom”

*Year ended December 31, 2003
with Report of Independent Auditors*

Open Joint Stock Company “VolgaTelecom”

Consolidated Financial Statements

Year ended December 31, 2003

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Independent Auditors' Report

To the Shareholders and Board of Directors of OJSC "VolgaTelecom"

1. We have audited the accompanying consolidated balance sheet of OJSC "VolgaTelecom" (a Russian open joint-stock company - hereinafter "the Company"), as of December 31, 2003, and the related consolidated statements of operations, cash flows and changes in shareholders' equity for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.
2. Except as discussed in paragraphs 3 and 5, we conducted our audit in accordance with International Standards on Auditing issued by the International Federation of Accountants. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.
3. As described in Note 12 "Investments in Subsidiaries", the Company accounted for the purchase of certain subsidiaries based on historical cost of their net assets. The Company did not identify and estimate the fair value of the purchased net assets as required by IAS 22, "Business Combinations". We were not able to quantify the adjustments, if any, required to reflect these acquisitions at fair value in the accompanying financial statements.
4. As described in Note 26 "Pension Plans and Employee Benefits", the Company has not determined and presented its obligations existing under defined benefits plans in accordance with IAS 19, "Employee Benefits". We were not able to quantify the adjustments, if any, to the financial statements. This matter caused us to qualify our audit opinion on the consolidated financial statements for the year ended December 31, 2002.

5. As described in Note 10 “Property, Plant and Equipment”, the Company’s accounting records relating to fixed assets are not designed to support their presentation in accordance with IAS 16, “Property, Plant and Equipment”, IAS 29, “Financial Reporting in Hyperinflationary Economies” and IAS 36, “Impairment of Assets”. As such, certain estimates were made by management to present fixed assets in the accompanying financial statements. Owing to the nature of the Company’s records, we were unable to satisfy ourselves as to the adjustments, if any, which might have been determined to be necessary had additional evidence been available to better analyze the assumptions and estimates made by management. This matter caused us to qualify our audit opinion on the consolidated financial statements for the year ended December 31, 2002.
6. As a result of the matters described in paragraphs 3, 4 and 5, adjustments, if any, could materially affect the following items: (i) property, plant and equipment, equipment contributions, intangible assets and goodwill, assets and liabilities under defined benefit plans, deferred income taxes, minority interest and retained earnings and other reserves as of December 31, 2003 and the related amounts of depreciation and amortization expense, wages, salaries, other benefits and payroll taxes, income tax expense, minority interest and net income for the year ended December 31, 2003, (ii) the related disclosures and (iii) the corresponding amounts for 2002.
7. In our opinion, except for the effects on the financial statements of such adjustments, if any, which might have been determined to be necessary for the matters referred to in paragraphs 3, 4 and 5, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of OJSC “VolgaTelecom” as of December 31, 2003, and the results of its operations and its cash flows for the year then ended in conformity with International Financial Reporting Standards.
8. Without further qualifying our opinion, we draw attention to Note 1 “General Information” to the consolidated financial statements which discloses that the current liabilities of OJSC “VolgaTelecom” exceeded its current assets by 2,935,235 thousand rubles as of December 31, 2003. Management’s plans in regards to this matter are also described in Note 1.
9. As described in Note 1, the Company was the subject of a reorganization that was approved by the shareholders on November 9, 2001. The Company has accounted for the merger based on the principles of uniting of interests as described in IAS 22, “Business Combinations”. In applying this method, the Company has reflected amounts in the financial statements as if the entities had been combined from January 1, 2002, the earliest period presented.

August 27, 2004

OJSC “VolgaTelecom”
Consolidated Balance Sheet

As of December 31, 2003

(in thousands, except share and per share amounts)

	Note	December 31, 2003	December 31, 2002 as restated
ASSETS			
Non-current assets:			
Property, plant and equipment	10	21,755,686	17,325,235
Intangible assets and goodwill	11	909,447	37,209
Investments in associates	13	219,080	111,721
Other long-term investments	14	24,120	66,173
Other financial assets	17	28,973	21,842
Advances to suppliers of equipment		133,391	117,948
Total non-current assets		23,070,697	17,680,128
Current assets:			
Inventories, net	15	502,375	467,619
Trade accounts receivable, net	16	1,122,748	746,690
Short-term investments	14	5,136	–
Other current assets	18	1,068,452	1,041,756
Cash and cash equivalents	19	327,284	214,863
Total current assets		3,025,995	2,470,928
TOTAL ASSETS		26,096,692	20,151,056
SHAREHOLDERS' EQUITY AND LIABILITIES			
Shareholders' equity:			
Preference shares	20	409,917	409,917
Ordinary shares	20	1,229,848	1,229,848
Inflation impact on share capital		2,213,925	2,213,925
Retained earnings and other reserves		11,138,246	9,720,449
Total shareholders' equity		14,991,936	13,574,139
Commitments and contingencies	27	–	–
Minority interest	21	776,472	342,039
Non-current liabilities:			
Long-term borrowings	22	2,541,338	878,066
Finance lease obligations	23	520,394	222,846
Equipment contributions		165,500	129,781
Deferred income tax liability	7	1,128,450	838,881
Other non-current liabilities		11,372	–
Total non-current liabilities		4,367,054	2,069,574
Current liabilities:			
Accounts payable and accrued liabilities	24	2,354,508	1,542,542
Payable to Rostelecom	28	199,897	174,803
Taxes and payroll related obligations	25	742,145	697,765
Dividends payable		222,476	206,050
Short-term borrowings	22	1,639,926	893,372
Current portion of long-term borrowings	22	481,169	457,718
Current portion of finance lease obligations	23	321,109	193,054
Total current liabilities		5,961,230	4,165,304
Total shareholders' equity and liabilities		26,096,692	20,151,056

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

OJSC “VolgaTelecom”

Consolidated Statement of Operations

For the year ended December 31, 2003

(in thousands, except share and per share amounts)

	<u>Note</u>	<u>2003</u>	<u>2002 as restated</u>
Revenues	4	16,771,131	13,202,423
Operating expenses			
Wages, salaries, other benefits and payroll taxes		(5,258,632)	(4,137,379)
Depreciation and amortization		(2,183,612)	(1,907,645)
Materials, repairs and maintenance, utilities		(1,545,113)	(1,414,897)
Taxes other than income tax		(272,769)	(394,353)
Interconnection charges		(2,001,626)	(1,497,269)
Bad debt expense		(498,120)	(194,984)
Loss on disposal of property, plant and equipment		(113,368)	(130,101)
Other operating expenses	5	(1,502,289)	(1,057,114)
Total operating expenses		(13,375,529)	(10,733,742)
Operating income		3,395,602	2,468,681
Income from associates		107,359	35,487
Interest expenses, net	6	(398,510)	(226,734)
Loss from other investments		(46,125)	(16,858)
Foreign exchange loss, net		(60,388)	(237,454)
Net monetary gain		-	244,959
Income before taxation and minority interest		2,997,938	2,268,081
Income tax expense	7	(960,734)	(1,184,279)
Income before minority interest		2,037,204	1,083,802
Minority interest	21	(244,664)	(168,754)
Net income		1,792,540	915,048
Dividends on preference shares	9	(200,941)	(147,193)
Net income attributable to ordinary shareholders		1,591,599	767,855
Basic and diluted earnings per share (Russian Rubles)	8	6.47	3.12

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

OJSC “VolgaTelecom”

Consolidated Statement of Cash Flows

For the year ended December 31, 2003

(in thousands, except share and per share amounts)

	2003	2002 as restated
Cash flows from operating activities:		
Income before taxation and minority interest	2,997,938	2,268,081
Adjustments to reconcile income (loss) to cash generated from operations:		
Foreign currency exchange loss, net	60,388	237,454
Net monetary gain	-	(244,959)
Depreciation and amortization	2,183,612	1,907,645
Loss on disposal of property, plant and equipment	113,368	130,101
(Income) from investments in associates	(107,359)	(35,487)
Interest expense, net	398,510	226,734
Bad debt expense	498,120	194,984
Loss from other investments	46,125	16,858
Operating profit before changes in working capital	6,190,702	4,701,411
(Increase) decrease in trade accounts receivable	(800,867)	102,047
Decrease (increase) in other current assets	34,708	(644,902)
(Increase) in inventories	(17,435)	(83,282)
Increase in accounts payable and accrued liabilities	305,410	434,620
Increase in taxes and payroll related obligations	167,327	347,182
Cash flows generated from operations	5,879,845	4,857,076
Interest paid	(389,820)	(231,347)
Income tax paid	(945,473)	(620,901)
Interest received	13,089	3,564
Net cash flows provided by operating activities	4,557,641	4,008,392
Cash flows from investing activities:		
Purchase of property, plant and equipment	(3,620,144)	(4,008,029)
Purchase of intangible assets	(729,170)	(15,034)
Purchase of subsidiaries	(924,840)	-
Proceeds from sales of property, plant and equipment	16,869	561,236
Dividends received	4,129	-
Net cash flows used in investing activities	(5,253,156)	(3,461,827)
Cash flows from financing activities		
Proceeds from borrowings	2,897,808	2,141,372
Repayment of borrowings	(1,781,750)	(1,696,321)
Proceeds from debt securities issued	988,106	-
Repayment of finance lease obligations	(284,220)	(113,835)
Repayment of vendor financing obligations	(633,482)	(493,186)
Proceeds from other non-current liabilities	11,895	-
Dividends paid to minority	(2,757)	(8,500)
Dividends paid	(326,334)	(108,845)
Net cash flows from (used in) financing activities	869,266	(279,315)
Monetary effects on cash and cash equivalents	-	(117,285)
Effects of exchange rate changes on cash and cash equivalents	(61,330)	(147,566)
Increase in cash and cash equivalents	112,421	2,399
Cash and cash equivalents at the beginning of the year	214,863	212,464
Cash and cash equivalents at the end of the year	327,284	214,863
Non-monetary operations:		
Property, plant and equipment acquired through vendor financing and on credit terms	868,964	674,773
Property, plant and equipment acquired under lease agreements	709,823	380,359
Equipment contributions	47,923	34,682

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

OJSC “VolgaTelecom”

Consolidated Statement of Changes in Shareholders’ Equity

For the year ended December 31, 2003

(in thousands, except share and per share amounts)

	Notes	Share Capital		Inflation impact on share capital	Retained earnings and other reserves	Total Shareholders’ equity
		Preferences hares	Ordinary shares			
At December 31, 2001 as restated	2	409,917	1,229,848	2,213,925	9,039,074	12,892,764
Net income for the year		–	–	–	915,048	915,048
Dividends	9	–	–	–	(233,673)	(233,673)
At December 31, 2002		409,917	1,229,848	2,213,925	9,720,449	13,574,139
Net income for the year		–	–	–	1,792,540	1,792,540
Dividends	9	–	–	–	(374,743)	(374,743)
At December 31, 2003		409,917	1,229,848	2,213,925	11,138,246	14,991,936

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

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

Year ended December 31, 2003

(in thousands, except share and per share amounts)

1. General Information

Authorization of Accounts

The consolidated financial statements of OJSC “VolgaTelecom” and its subsidiaries – (hereinafter “the Company” or “VolgaTelecom”) for the year ended December 31, 2003 were authorized for issue by its appointed General Director and Chief Financial Officer on August 27, 2004.

The Company

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

Open joint-stock company Svyazinvest, a federal holding company majority-owned by the Russian Federation, owns 51% of the Company’s ordinary shares.

The Company’s principal activity is providing local and long-distance telephone services. Other types of activity of the Company include production of telecommunication equipment and its technical support. The Company also provides cellular services in the Nizhny Novgorod, Kirov, Ulianovsk, Orenburg, Saratov regions and Republic of Udmurtia.

The average number of employees in the Company in 2003 was approximately 51,000 persons (in 2002 – 54,000).

The registered office of the Company is in the city of Nizhny Novgorod (the Russian Federation), Dom Svyazi, Maxim Gorky sq.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements (continued)

(in thousands, except share and per share amounts)

1. General Information (continued)

2002 Reorganization

In 2001 the Company's management started the Company's reorganization by obtaining shareholder approval to merge the following regional enterprises of OJSC “Svyazinvest” wherein 158,467,107 ordinary and 52,823,104 preferred shares of the Company were exchanged for 100% of the outstanding voting shares of the regional enterprises as follows:

Regional Enterprise	Ordinary shares issued by the Company	Preferred shares issued by the Company	Exchange Ratio
OJSC “Svyazinform” of Samara Region	49,211,737	16,403,965	24.8419
OJSC “Electrosvyaz” of Orenburg Republic	20,832,688	6,944,148	0.0721
OJSC “Saratovelectrosvyaz”	25,767,099	8,589,006	0.2014
OJSC “Udmurttelecom”	21,693,209	7,231,086	2.0070
OJSC “Kirovelectrosvyaz”	12,399,351	4,132,855	10.0965
OJSC “Svyazinform” of Chuvashiya Region	6,120,471	2,040,099	26.8936
OJSC “Martelecom” of Marii-El Republic	4,732,377	1,578,028	0.3627
OJSC “Svyazinform” of Mordoviya Republic	4,599,590	1,533,404	0.1440
OJSC “Svyazinform” of Penza Region	5,903,505	1,968,213	38.6916
OJSC “Electrosvyaz” of Ulianovsk Region	7,207,080	2,402,300	3.2152
Total	158,467,107	52,823,104	

The merger was completed and effective on November 30, 2002. Transaction costs related to the merger of 68,088 were expensed in 2002.

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

Liquidity and Financial Resources

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

Year ended December 31, 2003

(in thousands, except share and per share amounts)

As of December 31, 2003, the Company’s current liabilities exceeded its current assets by 2,935,235 (2002 – 1,694,376). As a result, significant uncertainties exist as to the Company’s liquidity position and future capital resources.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

Year ended December 31, 2003

(in thousands, except share and per share amounts)

1. *General Information (continued)*

Liquidity and Financial Resources (continued)

Primarily due to ongoing investments in maintenance and construction programs (construction of multi-service telecommunication network and expansion of existing fiber-optic networks), the Company requires cash flows from operations, debt and other long-term financing resources, including hard currency borrowings for which no commercially viable hedging instruments are available.

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

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

Through 2004, the Company anticipates funding from: a) cash generated from operations, b) sale of investments (see Note 30 “Subsequent events”), and c) other financing from domestic and international lending institutions. Management also expects to continue to be able to delay payment for certain operating costs to manage its working capital requirements if necessary.

The accompanying financial statements have been presented on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. Accordingly, the financial statements do not include any adjustments related to the recoverability and classification of recorded asset amounts or any other adjustments that might result should the Company either be unable to continue as a going concern or if the Company was to dispose of assets outside the normal course of its operating plan and had problems with regard to timely settlement of its short-term liabilities and short-term portion of long-term liabilities when they became due.

2. *Summary of Significant Accounting Policies*

Basis of Preparation

The Company maintains its accounting records and prepares its statutory accounting reports in Russian Rubles and in accordance with the Regulations on Accounting and Reporting in the Russian Federation. The accompanying consolidated financial statements presented in accordance with International Financial Reporting Standards (IFRS) are based upon the statutory accounting records that are maintained in accordance with the Russian accounting regulations under the historical cost convention. These statutory accounting records have been adjusted and reclassified to present the accompanying consolidated financial statements in accordance with IFRS. IFRS primarily includes standards and interpretations approved by

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Notes to Consolidated Financial Statements

Year ended December 31, 2003

(in thousands, except share and per share amounts)

the International Accounting Standards Board (IASB), International Accounting Standards Committee (IASC) and Standing Interpretations Committee (SIC).

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

Year ended December 31, 2003

(in thousands, except share and per share amounts)

2. Summary of Significant Accounting Policies (continued)

Management Estimates

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

Prior Period Adjustments and Reclassifications

Management of the Company chose to restate opening retained earnings and the results for the year ended December 31, 2002 for previously unrecorded adjustments. These adjustments relate to accrual of interconnection costs (these amounts had previously been reflected in the period invoiced), accrual of dividends due to the holders of preferred shares (the dividends had been previously reflected in the reporting period when formally declared) as well as deferred tax effects of temporary differences not previously recognized on fixed assets. The effect of these adjustments on previously reported amounts is as follows:

	<i>As previously reported</i>	As restated
Shareholder’s Equity, January 1, 2002	12,338,361	12,892,764
Net Income	915,048	915,048
Shareholder’s Equity, December 31, 2002	13,095,296	13,574,139
Basic and Diluted Earnings per Share	3.43	3.12

Certain amounts in the prior period consolidated financial statements have been reclassified to conform with the current year presentation.

Basis of Consolidation

The consolidated financial statements comprise the financial statements of the Company and its subsidiaries drawn up to December 31, 2003.

The Company has accounted for the reorganization (see Note 1 “General Information”) based on the principles of uniting of interests as described in IAS 22 “Business Combinations”.

Subsidiaries are consolidated from the date on which control is transferred to the Company and cease to be consolidated from the date on which control is transferred from the Company. Minority interests reflect the interests in subsidiaries not held by the Company (see Note 12 “Investments in Subsidiaries”).

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Notes to Consolidated Financial Statements

Year ended December 31, 2003

(in thousands, except share and per share amounts)

2. *Summary of Significant Accounting Policies (continued)*

Subsidiaries

A subsidiary is an entity that is controlled by the Company, directly or indirectly, generally through ownership of more than 50% of the voting share capital of the entity. These consolidated financial statements include the assets and liabilities, and revenues and expenses of the Company and of subsidiary undertakings, on a line-by-line basis.

Where subsidiaries are not controlled throughout the year, consolidated results include the results of those entities for that part of the year during which control existed, except where the Company has applied the uniting of interests method in accordance with IAS 22 “Business Combination”. Under the uniting of interests method, the financial statement items of the combining entities for the period in which the combination occurs are included in the consolidated financial statements as if they had been combined from the beginning of the first period presented.

Where the purchase method is applied to account for the acquisition of subsidiaries, identifiable assets and liabilities of subsidiaries are stated at their fair value as of the acquisition date. Minority interest at the date of acquisition is determined in proportion to minority shareholders’ share in the fair value of the assets and liabilities of the subsidiary at that date. The share of minority shareholders is estimated on the basis of the common voting shares and preferred shares owned by shareholders that do not exercise control over the subsidiary.

Balances and transactions between the Company and subsidiary, as well as any income from intercompany transactions are eliminated. Income (loss) from intercompany transactions is identified and eliminated only in cases where the assets transferred under relevant transactions have not been sold to third parties (i.e. non-Company entities) and are carried in the balance sheet of a Company entity as of the balance sheet date.

Associates

An associate is an entity in which the Company has significant influence, which is usually demonstrated by the Company owning between 20% and 50% of the voting share capital.

Under the equity method, the investments in associates are carried in the balance sheet at cost plus post-acquisition changes in the Company’s share of net assets of the associates, less any impairment in value. The income statement reflects the Company’s share of the results of operations of the associates.

Unrealized gains and losses arising from transactions with associates are eliminated in proportion to the Company’s interest in the associates by adjusting the book value of investments.

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Notes to Consolidated Financial Statements

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(in thousands, except share and per share amounts)

2. Summary of Significant Accounting Policies (continued)

Goodwill

For investments in subsidiaries and associates, any excess of the cost of acquisition over the Company's share in the fair value of net identifiable assets and liabilities of the acquired entity is recognized as goodwill. Goodwill is amortized on a straight-line basis over its useful life, which according to management's expectations is approximately 5 years. It is reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable. Goodwill is stated at cost less accumulated amortization and any impairment in value.

Goodwill on acquisition of associates is included in the carrying amount of investments in associates.

Upon disposal of investments in a subsidiary or an associate the remaining balance of unamortized goodwill is taken to gains or losses from such disposal.

Negative goodwill

Negative goodwill is the excess of the Company's share in the fair value of net identifiable assets and liabilities of a subsidiary or an associate at the date of acquisition over the purchase price paid.

Negative goodwill is allocated to income on the basis of a review of the circumstances giving rise to it, as follows:

- to the extent that negative goodwill is included in future losses or expenses projected at the date of acquisition it is charged to income in the period when such losses or expenses arise;
- to the extent that negative goodwill is included in acquired amortized assets it is recognized as income on a straight-line basis over the remaining weighted average useful life of such amortized assets; and
- negative goodwill amount in excess of the fair value of all acquired non-monetary assets is directly recognized as income.

Negative goodwill arising from acquisition of an associate is charged to the carrying amount of investments in this associate.

Negative goodwill arising from acquisition of a subsidiary is recognized in the balance sheet as a reduction of assets.

Accounting for the Effects of Inflation

In 2000 – 2002 the Russian Federation met the definition of a hyperinflationary economy, as defined by International Accounting Standard 29 “Financial Reporting in Hyperinflationary Economies” (IAS 29). The inflation rate based on the Russian consumer price index (“CPI”),

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Notes to Consolidated Financial Statements

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(in thousands, except share and per share amounts)

as calculated by the State Committee on Statistics (Goskomstat), was 15.1% for 2002 (18.6% and 20.2% for 2001 and 2000, respectively). Although the cumulative inflation index for the three-year period ended in 2002 was less than 100%, it was considered that the remaining criteria set forth by IAS 29 indicated that the Russian Federation continued to experience conditions that meet the definition of a hyperinflationary economy during 2002.

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Notes to Consolidated Financial Statements

Year ended December 31, 2003

(in thousands, except share and per share amounts)

2. Summary of Significant Accounting Policies *(continued)*

Accounting for the Effects of Inflation *(continued)*

IAS 29 requires that financial statements prepared in the currency of a hyperinflationary economy be stated in terms of the measuring unit current at the balance sheet date. In applying IAS 29, the Company used conversion factors derived from the Russian CPI.

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

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

The main guidelines followed in adjusting the consolidated financial statements as of December 31, 2002 to current purchasing power at December 31, 2002 are:

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

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Notes to Consolidated Financial Statements

Year ended December 31, 2003

(in thousands, except share and per share amounts)

2. Summary of Significant Accounting Policies (continued)

Accounting for the Effects of Inflation (continued)

Effective from January 1, 2003, international accounting and financial reporting bodies have determined that the Russian Federation no longer meets the criteria of IAS 29 for hyperinflation. Beginning 2003, the Company ceased applying IAS 29 and only recognizes the cumulative impact of inflation indexing through December 31, 2002, on non-monetary elements of the financial statements. Transactions undertaken subsequent to December 31, 2002 are reported at actual, nominal amounts except for those involving non-monetary assets and liabilities acquired prior to January 1, 2003. Results of operations (including gains and losses on disposal) involving such assets and liabilities are recognized based on the “restated cost”, which was calculated by applying through December 31, 2002 the relevant conversion factors to the carrying values of these assets and liabilities.

Foreign Currency Translation

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

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

Property, Plant and Equipment

Property, plant and equipment is stated at cost less accumulated depreciation and any impairment in value.

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

Buildings	45 years
Constructions	20 years
Switches	15 years
Transmission devices	10 years
Computers	5 years
Transport	5 years
Other	3 years

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Notes to Consolidated Financial Statements

Year ended December 31, 2003

(in thousands, except share and per share amounts)

2. *Summary of Significant Accounting Policies (continued)*

Property, Plant and Equipment (continued)

For the purpose of disclosure, Property, Plan and Equipment are aggregated into the following groups:

- Buildings and constructions;
- Switches and transmission devices;
- Machines and other, in which computers, vehicles and other items are included.

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

Construction in progress is recorded as the total of actual expenses incurred by the Company from the beginning of construction to the reporting date, adjusted for the effect of inflation (for periods prior to January 1, 2003) from the date when such expenses occur to the reporting date in accordance with IAS 29. Accrual of depreciation begins when fixed assets are put into operation.

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

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

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

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2. *Summary of Significant Accounting Policies (continued)*

Equipment Contributions and Government Grants

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

Equipment contributions that do not generate any future income for the Company are not recognized.

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

When the grant relates to an income item, it is recognized as income over the periods necessary to match the grant on a systematic basis to the cost that it is intended to compensate.

Intangible Assets

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

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

Research and Development Costs

Research and development costs are expensed as incurred.

Investments

Financial investments include the following three categories: held-to-maturity investments, investments available-for-sale and investments held for trading.

All investments are initially recognized at cost, being the fair value of the consideration given and including acquisition charges associated with the investment.

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After initial recognition, investments that are classified as held for trading are measured at their fair value. Gains or losses on trading securities are recognized in the income statement and included into income (loss) from financial investments.

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Notes to Consolidated Financial Statements

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(in thousands, except share and per share amounts)

2. *Summary of Significant Accounting Policies (continued)*

Investments (continued)

Investments that are intended to be held to maturity, that have fixed maturity, being initially recorded at cost, are subsequently measured at amortized cost using the effective interest rate method. Amortized cost is calculated by taking into account any discount or premium on acquisition, over the period to maturity. For investments carried at amortized cost, gains and losses are recognized in income when the investments are derecognized or impaired, as well as through the amortization process. Those that do not have a fixed maturity are measured at cost.

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

Other Financial Assets

Other Financial Assets consist of Long-term Accounts Receivable, Long-term Loans Granted to personnel and other financial assets. They are accounted at amortized cost using the effective interest rate.

Inventories

Inventories, which are mainly comprised of cable, materials, spare parts for telecommunications equipment and goods for resale, are priced at the lower of cost or net realizable value. Cost is determined using the average cost method.

Transportation, insurance and other similar expenditures incurred to bring inventories to their existing condition and location are included into the cost of raw materials and goods for resale.

Accounts Receivable

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

Cash and Cash Equivalents

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

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Interest-Bearing Loans and Borrowings

All interest-bearing loans and borrowings are initially recognized at cost of consideration received. After initial recognition, interest-bearing loans and borrowings are subsequently measured at cost plus accrued interest calculated using the effective interest rate method.

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(in thousands, except share and per share amounts)

2. *Summary of Significant Accounting Policies (continued)*

Non Interest-Bearing Loans and Borrowings

The initial recognition of non interest-bearing loans and borrowings and equipment received for non-interest-bearing loans and borrowings are made at their fair market value estimated by discounting future payments to their present value. Market interest rates are approximated by using the prevailing rates of return for the Company’s financial instruments having substantially the same terms and characteristics. The subsequent measurement of interest-bearing loans and borrowings are carried at amortized cost using the effective interest rate method.

Provisions

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

Pensions and Other Post-Employment Benefits

State Plans

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

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

Other pension and post-retirement benefits

Under collective bargaining agreements, the Company also provides post-employment retirement benefits by using defined contribution plans and defined benefit plans. The majority of the Company’s employees are eligible to participate under defined benefit plans based upon a number of factors, including years of service, age and compensation.

A defined contribution plan is a post-employment benefit plan under which the Company’s liability is limited solely to the amount of a contribution it agrees to pay into a fund. In this case

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all actuarial and investment risks will be borne by employees. The Company recognizes contributions under a defined contribution plan in the period to which they are attributable.

Under defined benefit plans, the Company’s obligation is to provide the agreed benefits to current and former employees whereby actuarial and investment risks fall, in essence, on the Company.

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2. Summary of Significant Accounting Policies *(continued)*

Leases

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

Capitalized leased assets are depreciated using the straight-line method over the estimated economic useful life of the asset as for owned assets within the same class, with consideration of the contractual terms under which the assets can be used.

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

Revenue

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

The Company categorizes the revenue sources in twelve major categories:

1. Long distance telephone services - domestic;
2. Long distance telephone services - international;
3. Local telephone services;
4. Installation and connecting fees;
5. Documentary services;
6. Mobile telecommunication services;
7. Radio and TV broadcasting;
8. Data transfer and telematic services;
9. New services;
10. Rent of telephone channels;
11. Other telecommunications services;
12. Other revenues.

Long distance telephone services (domestic and international)

Revenues from subscribers for long distance services depend on time of call, duration of call, destination of call, type of service used, subscriber category and the applied rate plan. The Company charges long distance fees on a per-minute basis. The Company recognizes revenues related to the long distance services in the period when the services are rendered.

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2. *Summary of Significant Accounting Policies (continued)*

Revenue (continued)

Long distance telephone services (domestic and international) (continued)

Revenue from long-distance services (domestic) includes also revenue from national telephone operators, which comprises two major groups.

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

In 2003 the Ministry of the Russian Federation for Antimonopoly Policy and Entrepreneurial Support (MAP) has conducted a reform of the settlements system of multi regional OJSC “Svyazinvest” companies with OJSC “Rostelecom” for transit of intercity long-distance traffic. Till August 1, 2003 the revenue calculation had been based on the integral settlement rate, multiplied by the total number of minute-distances (transfer of 1 minute of traffic on 50 kilometer intervals of OJSC “Rostelecom” network), transferred through the period.

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

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

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

OJSC “VolgaTelecom”

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Year ended December 31, 2003

(in thousands, except share and per share amounts)

2. *Summary of Significant Accounting Policies (continued)*

Revenue (continued)

Long distance telephone services (domestic and international) (continued)

The second group of revenues from national operators represents services rendered to interconnected telecom operators that transfer the traffic of their customers via the Company’s network.

Major revenues are recognized from the services for transit of the traffic and interconnection to the network (one time fees).

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

Local telephone services

Revenue from the local telephone services depends on the duration of the telephone connections and subscription fee, while time driven billing scheme is applied. If fixed payment scheme is applied then revenue depends on the subscription fee only. The Company recognizes revenues related to the monthly network fees for local services in the month the service is provided to the subscriber.

Installation and connecting fees

The Company recognizes installation and connecting fees for indefinite contracts with its subscribers as revenues when the installation and connection are complete.

Documentary services

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

Mobile telecommunication services

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

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

Year ended December 31, 2003

(in thousands, except share and per share amounts)

2. *Summary of Significant Accounting Policies (continued)*

Revenue (continued)

Radio and TV broadcasting

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

Data transfer and telematic services

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

New services

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

Rent of telephone channels

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

Other telecommunication services

Other telecommunication services primarily consist of revenues received by public switched telephone network (PSTN) stations from the rent of direct lines and local interconnection. The Company recognizes revenues related to other services in the period when the services are rendered.

Other revenues

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

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Notes to Consolidated Financial Statements

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2. Summary of Significant Accounting Policies (continued)

Income Tax

Deferred income tax assets and liabilities are calculated in respect of temporary differences in accordance with IAS 12 “Income Taxes” (later IAS 12).

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

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

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

A deferred tax liability is recognized for all taxable temporary differences associated with investments in subsidiaries, associates, and interests in joint ventures, except to the extent that both of the following conditions are satisfied: the Company is able to control the timing of the reversal of the temporary difference; and it is probable that the temporary difference will not reverse in the foreseeable future.

Value-Added Tax

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

Contingencies

Contingent liabilities are not recognized in the financial statements. They are disclosed unless the possibility of an outflow of resources embodying economic benefit is remote.

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

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

Year ended December 31, 2003

(in thousands, except share and per share amounts)

Subsequent Events

Post-year-end events that provide additional information about the Company’s position at the balance sheet date (adjusting events), are reflected in the financial statements. Post-year-end events that are not adjusting events are disclosed when material.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements (continued)

(in thousands, except share and per share amounts)

3. Segment Information

	2003			2002				
	Fixed line	Mobile	Intercompany eliminations	Total for the Company	Fixed line	Mobile	Intercompany eliminations	Total for the Company
REVENUE								
Sales	14,938,211	2,077,025	(244,105)	16,771,131	11,600,711	1,689,726	(88,014)	13,202,423
Inter-segment sales	(244,105)	–	244,105	–	(88,014)	–	88,014	–
Total revenue	14,694,106	2,077,025	-	16,771,131	11,512,697	1,689,726	–	13,202,423
GROSS PROFIT								
Segment operating result	2,813,887	621,237	–	3,435,124	1,990,875	477,806	–	2,468,681
Unallocated corporate expenses				(39,522)				–
Operating income				3,395,602				2,468,681
Income from associates				107,359				35,487
Interest expenses, net				(398,510)				(226,734)
Loss from other investments				(46,125)				(16,858)
Foreign exchange loss, net				(60,388)				(237,454)
Net monetary gain				–				244,959
Income tax expense				(960,734)				(1,184,279)
Minority interest				(244,664)				(168,754)
Net income				1,792,540				915,048

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements (continued)

(in thousands, except share and per share amounts)

3. Segment Information (continued)

	2003				2002			
	Fixed line	Mobile	Intercompany eliminations	Total for the Company	Fixed line	Mobile	Intercompany eliminations	Total for the Company
OTHER INFORMATION								
Segment assets	22,012,200	3,724,252	–	25,736,452	18,478,050	1,561,285	–	20,039,335
Investments in associates	–	–	–	219,080	–	–	–	111,721
Unallocated corporate assets	–	–	–	141,160	–	–	–	–
Consolidated total assets				26,096,692				20,151,056
Segment liabilities	(8,816,475)	(1,511,809)	–	(10,328,284)	(5,489,760)	(745,118)	–	(6,234,878)
Minority interest	–	–	–	(776,472)	–	–	–	(342,039)
Consolidated total liabilities				(11,104,756)				(6,576,917)
Capital expenditure	(4,334,951)	(794,060)	–	(5,129,011)	(4,528,839)	(594,221)	–	(5,123,060)
Depreciation and amortization	(1,787,597)	(396,015)	–	(2,183,612)	(1,641,752)	(265,893)	–	(1,907,645)
Other non-cash expenses, excl. depreciation (bad debt expenses)	(494,087)	(4,033)	–	(498,120)	(167,637)	(27,347)	–	(194,984)

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements (continued)

(in thousands, except share and per share amounts)

3. Segment Information (continued)

The Company provides fixed line and mobile telecommunication services, as well as other services. Management believes that the Company operates in one geographical segment, i.e. on the territory of Povolzhie region of Russia.

4. Revenues

	2003	2002
By revenue types		
Long distance telephone services - domestic	5,771,964	4,469,559
Long distance telephone services - international	764,346	744,436
Local telephone services	4,094,433	3,323,820
Installation and connecting fees	1,407,752	1,025,783
Documentary services	137,270	154,345
Mobile telecommunication services	2,077,025	1,426,046
Radio and TV broadcasting	416,123	388,299
Data transfer and telematic services	87,731	66,591
New services	444,191	233,079
Rent of telephone channels	520,698	328,789
Other telecommunications services	432,983	560,347
Other revenues	616,615	481,329
Total	16,771,131	13,202,423

The change to the new scheme of settlements with OJSC “Rostelecom” in August 2003 allowed the Company to receive revenue for the termination of traffic on its network depending on the actual amount of traffic in the period leading to an increase in revenue from long distance telephone services – domestic of 380,513. The costs of settlements with OJSC “Rostelecom” for the transfer of intercity traffic due to the change of the scheme increased by approximately the same amount.

The Company identifies revenue by the following major customer groups:

Customer groups	2003	2002
Residential customers	9,036,794	6,669,215
Corporate customers	5,663,373	4,888,729
Government customers	1,151,895	1,304,512
Tariff compensation from the state budget	919,069	339,967
Total	16,771,131	13,202,423

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements (continued)

(in thousands, except share and per share amounts)

5. Other Operating Expenses

	2003	2002
General and administrative	369,668	303,971
Cost of goods sold	266,775	257,848
Rent expense	122,610	112,347
Audit and consulting	51,324	56,571
Non-commercial partnership expenses	135,804	104,233
Advertising	108,367	71,622
Insurance	69,138	20,700
Other expenses	378,603	129,822
Total	1,502,289	1,057,114

Other expenses primarily consist of expenses for social sphere expenses, charity and general activity for direction and management.

General and Administrative Expenses

	2003	2002
Payments to Gossvyaznadzor	58,765	75,438
Fire and other security services	130,485	101,290
Business travel expenses and representation costs	42,275	40,349
Transportation services	32,732	35,060
Post services	38,727	28,747
Education expenses	26,503	16,982
Other general and administrative expenses	40,181	6,105
Total	369,668	303,971

6. Interest Expenses, net

	2003	2002
Interest income	(13,089)	(3,564)
Interest expense	397,459	232,536
Interest expense accrued on financial leases	145,318	39,819
Less: capitalized interest	(131,178)	(42,057)
Total	398,510	226,734

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements (continued)

(in thousands, except share and per share amounts)

7. Income Tax

The income tax charge for the years ended December 31, 2003 and 2002 comprised the following:

	2003	2002
Current income tax expense	864,921	652,479
Deferred income tax charges relating to origination and reversal of temporary differences	95,813	531,800
Total income tax charge for the year	960,734	1,184,279

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

	2003	2002
Profit before income tax and minority interest	2,997,938	2,268,081
Statutory income tax rate	24%	24%
Theoretical tax charge at statutory income tax rate	719,505	544,339
Increase (decrease) resulting from the effect of:		
Non-taxable income	(34,224)	–
Expenses not deductible for tax purposes	233,004	241,926
Amortization of goodwill	9,485	–
Permanent elements of monetary gain	–	302,222
Other reconciling items	32,964	95,792
Total income tax charge for the year at the effective rate of 32% (2002 – 52%)	960,734	1,184,279

The composition of deferred income tax assets and liabilities as of December 31, 2003 and 2002, and their movement in the year ended December 31, 2003 and 2002 were as follows:

	2003	2002
<i>Tax effects of deferred income tax assets:</i>		
Accounts payable	26,289	104,804
Accounts receivable	91,267	29,172
Finance lease	96,129	74,662
Other		
Deferred income tax asset, total	213,685	208,638
<i>Tax effects of deferred income tax liabilities:</i>		
Property, plant and equipment	(1,278,819)	(1,014,170)
Financial investments	(55,694)	(29,752)
Inventory	(7,622)	(3,597)
Deferred income tax liability, total	(1,342,135)	(1,047,519)
Net deferred income tax liability	(1,128,450)	(838,881)

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements (continued)

(in thousands, except share and per share amounts)

7. Income Tax (continued)

The movement in net deferred income tax liability for the year ended December 31, 2003 was as follows:

Deferred income tax liability as of December 31, 2002	(838,881)
Deferred income tax expense	(95,813)
Share in deferred income tax of acquired companies	(193,756)
Deferred income tax liability as of December 31, 2003	(1,128,450)

8. Earnings per Share

Basic and diluted earnings per share are calculated by dividing the net income for the year attributable to ordinary shareholders (net income for the period less preferred dividends) by the weighted average number of ordinary shares outstanding during the year.

	2003	2002
Net income attributable to ordinary shareholders (basic and diluted)	1,591,599	767,855
Weighted average number of ordinary shares for basic and diluted earnings per share	245,969,590	245,969,590
Earnings per ordinary share, Rubles (basic and diluted)	6.4	3.12

The Company has no financial instruments that can be converted into ordinary shares.

9. Dividends Declared and Proposed for Distribution

Dividends declared in 2003 for the year 2002

Dividends on ordinary shares, 0.71 Rubles per share	173,802
Dividends on preferred shares, 1.80 Rubles per share	147,193
Total	320,995

Approved at the annual shareholders meeting for the year 2003 (see Note 30 “Subsequent Events”)

Dividends on ordinary shares, 0.92 Rubles per share	225,948
Dividends on preferred shares, 2.45 Rubles per share	200,941
Total	426,889

Earnings available for dividends are limited to profits determined in accordance with Russian statutory accounting regulations.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements (continued)

(in thousands, except share and per share amounts)

10. Property, Plant and Equipment

	Buildings and constructions	Switches and transmission devices	Construction in progress and equipment for installation	Machines and other	Total
Cost					
At December 31, 2002	22,681,267	23,981,044	1,081,325	5,460,850	53,204,486
Additions	–	–	5,129,011	–	5,129,011
Additions resulting from acquisition of subsidiary	228,500	1,085,000	263,932	24,899	1,602,331
Disposals	(206,917)	(778,220)	(19,908)	(135,133)	(1,140,178)
Transfers	1,840,680	2,697,132	(5,058,136)	520,324	–
At December 31, 2003	24,543,530	26,984,956	1,396,224	5,870,940	58,795,650
Impairment					
At December 31, 2002	(299,273)	(297,260)	–	(69,152)	(665,685)
Impairment loss on disposal of Property, Plant and Equipment	6,572	1,271	–	3,867	11,710
At December 31, 2003	(292,701)	(295,989)	–	(65,285)	(653,975)
Accumulated depreciation					
At December 31, 2002	(14,788,468)	(16,886,361)	–	(3,538,737)	(35,213,566)
Charge for the year	(479,991)	(1,257,308)	–	(395,529)	(2,132,828)
Disposals	101,049	696,820	–	162,536	960,405
At December 31, 2003	(15,167,410)	(17,446,849)	–	(3,771,730)	(36,385,989)
Net book value as of December 31, 2002	7,593,526	6,797,423	1,081,325	1,852,961	17,325,235
Net book value as of December 31, 2003	9,083,419	9,242,118	1,396,224	2,033,925	21,755,686

The net book value of plant and equipment held under finance leases at December 31, 2003 is 1,202,206 (2002 – 604,018). Leased assets are pledged as security for the related finance lease obligations (see Note 23 “Finance Lease Obligations”).

In 2003, the Company increased construction in progress by the amount of capitalized interest totaling 131,178 (2002 – 42,057).

Property, plant and equipment for the total of 5,751,509 as of December 31, 2003 (2002 – 3,636,679) is pledged as security for the Company’s borrowings (see Note 22 “Loans and Borrowings”).

Net book value of property, plant and equipment received under vendor financing amounted to 965,019 (2002 – 722,048).

The Company’s accounting records related to property, plant and equipment are not designed to support their presentation in accordance with IAS 16, “Property, Plant and Equipment”, IAS 29, “Financial Reporting in Hyperinflationary Economies” and IAS 36, “Impairment of Assets”. As such, certain estimates and assumptions were made by management to present fixed assets in the accompanying consolidated financial statements.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements (continued)

(in thousands, except share and per share amounts)

10. Property, Plant and Equipment (continued)

The Company plans to hire an independent appraiser to assist in appraisal of the fair value of the Property, Plant and Equipment, in order to make the necessary adjustments, if any, to the Company’s books and records, to comply with IFRS.

11. Intangible Assets and Goodwill

	Goodwill	Licenses	Software	Other	Total
Cost					
At December 31, 2002	–	9,836	35,348	184	45,368
Additions	–	8,071	720,662	512	729,245
Additions due to acquisition of subsidiaries	180,682	13,233	–	–	193,915
Disposals	–	–	(385)	(142)	(527)
At December 31, 2003	180,682	31,140	755,625	554	968,001
Accumulated Depreciation					
At December 31, 2002	–	(1,263)	(6,740)	(156)	(8,159)
Charge for the year	(39,522)	(1,492)	(9,716)	(54)	(50,784)
Disposals	–	–	384	5	389
At December 31, 2003	(39,522)	(2,755)	(16,072)	(205)	(58,554)
Net book value at					
December 31, 2002	–	8,573	28,608	28	37,209
Net book value at					
December 31, 2003	141,160	28,385	739,553	349	909,447

In accordance with the Board decision of OJSC “Svyazinvest”, the Company’s parent, dated April 14, 2003 the Company was instructed to proceed with the purchase and implementation of an enterprise management system (ERP) based on Oracle E-business Suite software. The Company’s Board of Directors confirmed this decision on May 28, 2003 and approved a supply contract with CJSC “Otkrytye tekhnologii 98” in the amount of 21,915 thousand US dollars excluding VAT (approximately 665,450).

In accordance with the supply contract, the Company has been provided with non-exclusive licenses for 13,029 users of E-business Suite among other license applications.

The Company will commence amortization of these costs upon substantial completion of implementation. Prior to this time management will periodically assess this intangible asset for impairment. The Company expects to complete this system implementation in 2007.

Licenses and software are amortized on a straight-line basis over their estimated useful lives determined equal to the term of the license or the license agreement for software. Useful lives of other intangible assets are 5-10 years.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements (continued)

(in thousands, except share and per share amounts)

12. Investments in Subsidiaries

The consolidated financial statements include the assets, liabilities and financial results of OJSC “VolgaTelecom” and its subsidiaries, whose main activity is providing cellular services. These subsidiaries are Russian legal entities registered in accordance with Russian regulations.

Name	Main activity	Voting Share (%) 2003	Voting Share (%) 2002
CJSC “Tsifrovye Telecommunicatsii”	Local telephone network services	100	81
LLC “Udmurtskie sotovye seti-450”	Cellular services (NMT-450)	100	100
CJSC “Nizhegorodskaya Sotovaya svyaz” (NCC)	Cellular services (GSM-900)	100	50
CJSC “Telesvyazinform”	Cable and air TV services	100	100
LLC “Vyatka-Page”	Paging services	91	91
CJSC “Puls Radio Ioshkar-Iola”	Radio services	61	61
CJSC “Sotovaya svyaz Mordovii”	Cellular services (GSM-900)	60	60
LLC “ChOP ROS”	Security services	60	60
CJSC “Narodny Telephone Saratov”	Cellular services (CDMA)	51	51
CJSC “Orenburg GSM”	Cellular services (GSM-900)	51	51
LLC Vyatskaya sotovaya svyaz”	Cellular services (NMT-450)	51	51
CJSC “Ulianovsk –GSM”	Cellular services (GSM-900)	51	51
LLC “RadioResonans”	Radio services	51	51
LLC Russian-American SP “Izhcom”	Data transmission and telematic services	51	51
CJSC “Nizhegorodsky radiotelephone”	Local telephone network services	50	50
CJSC “Chery - Page”	Paging services	50	50
OJSC “Tatincom-T”	Cellular services (GSM-900)	50	–
NPF “Doverie”	Pension fund	–	75

In February 2003 the Company increased its stake in CJSC “Nizhegorodskaya Sotovaya svyaz” by purchasing the remaining 50% interest for cash consideration of 20 million US dollars (approximately 641,000).

In September 2003 the Company acquired 50%+1 share in OJSC “Tatincom-T” for consideration of 15.6 million US dollars (approximately 474,000).

In December 2003 2,415 was paid for the 19% minority interest of CJSC “Tsifrovye Telecommunicatsii”.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements (continued)

(in thousands, except share and per share amounts)

12. Investments in Subsidiaries (continued)

The Company’s management has assigned the acquisition price for the 50 % interest in CJSC “Nizhegorodskaya Sotovaya svyaz” as follows:

Acquisition price	630,169
Transaction costs	10,991
Total paid	<u>641,160</u>
Assigned value of identifiable assets and liabilities:	
Property, plant and equipment, net	756,427
Intangible assets, net	24,065
Other non-current assets	22,671
Accounts receivable	23,415
Cash and cash equivalents	49,992
Other current assets	60,441
Current liabilities	(129,110)
Long-term liabilities	(78,635)
Total net assets	<u>729,266</u>
Company's share in acquired net assets	50%
Assigned value of acquired share in identifiable net assets	<u>364,633</u>
Goodwill	<u>276,527</u>
Amortization of goodwill since the acquisition date to December 31, 2003	<u>(41,479)</u>
Amount of goodwill at December 31, 2003, net	<u><u>235,048</u></u>

The Company’s management has assigned the acquisition price for the 50%+1 share in OJSC “Tatincom-T” as follows:

Acquisition price	454,656
Transaction costs	19,280
Total paid	<u>473,936</u>
Assigned value of identifiable assets and liabilities:	
Property, plant and equipment, net	1,602,331
Intangible assets, net	13,172
Accounts receivable	60,126
Cash and cash equivalents	8,628
Other current assets	78,924
Current liabilities	(240,034)
Long-term liabilities	(383,585)
Total net assets	<u>1,139,562</u>
Company's share in acquired net assets	50%
Assigned value of acquired share in identifiable net assets	<u>569,781</u>
Negative Goodwill	<u>(95,845)</u>
Amortization of negative goodwill since the acquisition date to December 31, 2003	<u>1,957</u>
Amount of negative goodwill at December 31, 2003, net	<u><u>(93,888)</u></u>

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements (continued)

(in thousands, except share and per share amounts)

12. Investments in Subsidiaries (continued)

The Company did not estimate the fair value of the acquired assets and liabilities of CJSC “Nizhegorodskaya Sotovaya svyaz” and OJSC “Tatincom-T” as required by IAS 22 “Business Combinations”. For determination of goodwill, management used an assumption that historical net book value of assets and liabilities equaled their fair value.

13. Investments in Associates

Investments in associates at December 31, 2003 and 2002 comprised the following:

Associate	Activity	As of December 31, 2003		As of December 31, 2002	
		Voting shares	Carrying value	Voting shares	Carrying value
CJSC “Tsifrovye Seti Udmurtii-900”	Cellular services (GSM-900)	49%	120,320	49%	41,590
CJSC “Samara Telecom”	Local telephone network services	28%	64,583	28%	45,899
CJSC “Transsvyaz”	Local telephone network services	40%	1,196	40%	1,458
OJSC “Telesot”	Local telephone network services	32%	9,093	32%	6,826
ACB “S-Bank”	Banking services	42%	16,944	42%	6,884
CJSC “Sotel - NN”	Cellular services	20%	–	20%	1,269
Other	Cellular and telephone services	20%-49%	6,944	20%-49%	7,795
Total			219,080		111,721

The Company has investments in the following associates whose net assets are negative as of December 31, 2003 and 2002:

Name	Activity	Voting share, %	Net assets as of December 31,	
			2003	2002
CJSC “Saratov-Mobile”	Cellular services (AMPS)	50%	(51,089)	(41,425)
CJSC “Sotel-NN”	Cellular services (NMT-450)	20%	(8,509)	–
CJSC “Chuvashiya Mobile”	Cellular services (AMPS)	30%	(53,824)	(55,242)

Movement in investments in associates in 2003 is presented below:

Investments in associates at December 31, 2002	111,721
Share in change in net assets of associates, net of dividends received	107,359
Investments in associates at December 31, 2003	219,080

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements (continued)

(in thousands, except share and per share amounts)

13. Investments in Associates (continued)

The carrying value of investments in associates shown in these consolidated financial statements is equivalent to the Company’s share in the net assets of investees, except for investments in CJSC “Saratov-Mobile”, CJSC “Sotel-NN” and CJSC “Chuvashiya Mobile”, which reported accumulated losses as of December 31, 2003. As the Company’s share in accumulated losses of these associates exceeded the cost of the respective investments, in accordance with IAS 28 “Accounting for Investments in Associates”, the carrying amounts of the investments were reduced to zero.

14. Other Long-term Investments and Short-term Investments

As of December 31, 2003 and 2002, the Company’s investments comprised the following:

	2003	2002
Long-term investments held-to-maturity	24,120	66,173
Short-term investments held-to-maturity	5,136	–
Total investments	29,256	66,173

15. Inventories, net

Inventories at December 31, 2003 and 2002 included the following:

	2003	2002
Cable, materials and spare parts for telecommunications equipment	290,957	243,115
Finished goods and goods for resale	33,920	39,510
Other inventories	177,498	186,350
Less: provision for obsolescence	–	(1,356)
Total	502,375	467,619

16. Trade Accounts Receivable, net

Trade accounts receivable as of December 31, 2003 and 2002 comprised the following:

	2003	2002
Trade receivables – telecommunication services	1,882,618	1,002,370
Less: allowance for doubtful accounts	(759,870)	(255,680)
Total	1,122,748	746,690

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements (continued)

(in thousands, except share and per share amounts)

16. Trade Accounts Receivable, net (continued)

The Company identified trade receivables by the following major customer groups:

	2003	2002
Corporate customers	502,542	379,517
Residential customers	635,274	302,737
Government customers, including tariff compensation from the state budget	744,802	320,116
Total	1,882,618	1,002,370

17. Other Financial Assets

As of December 31, 2003 and 2002, other financial assets included:

	2003	2002
Long-term accounts receivable	4,346	161
Long-term loans given to employees	24,627	21,681
Total	28,973	21,842

18. Other Current Assets

As of December 31, 2003 and 2002 other current assets comprised the following:

	2003	2002
Prepayments and advance paid	176,710	184,847
Settlements with personnel	23,958	20,164
Short-term loans given to employees	3,972	10,016
VAT recoverable	686,758	565,041
Prepaid income tax	59,606	101,994
Other prepaid taxes	18,358	29,464
Other receivables	99,433	137,900
Less: allowance for other current assets	(343)	(7,670)
Total	1,068,452	1,041,756

19. Cash and Cash Equivalents

As of December 31, 2003 and 2002 cash and cash equivalents comprised the following:

	2003	2002
Cash at bank and on hand	278,480	169,421
Cash equivalents	48,804	45,442
Total	327,284	214,863

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements (continued)

(in thousands, except share and per share amounts)

20. Share Capital

	2003 / 2002	
	Shares	Share capital
Preferred shares at par value		
5 Rubles:		
•shares authorized	82,514,900	
•shares issued and outstanding as of December 31	81,983,404	409,917
Ordinary shares at par value		
5 Rubles:		
•shares authorized	247,268,683	
•shares issued and outstanding as of December 31	245,969,590	1,229,848
Total share capital		1,639,765

As a result of the reorganization (see Note 1 “General Information”) the state registration of amendments to the charter documents was completed on November 30, 2002.

The share capital account represents the authorized capital of the Company as stated in the charter documents. The Company had 245,969,590 ordinary shares and 81,983,404 preference shares type A issued as of December 31, 2003 and 2002. All shares have a par value of 5 rubles. All shares were fully paid. There is no treasury stock as of December 31, 2003 and 2002.

Of the capital stock issued as of December 31, 2003, 75% was attributable to ordinary shares and 25% attributable to preference shares, type A. The common shareholders are allowed one vote per share. Preference shares type A are non-voting. All ordinary shares and preference shares type A are eligible for distribution of earnings available in accordance with Russian statutory accounting regulations. Preference shares type A are guaranteed an annual payment of dividends in the amount equal to 10% of statutory income available for dividends. Each preference share type A is entitled to a minimum annual dividend distribution that is not less than the distribution for each ordinary share for the same year. Shareholders of preference shares type A have a preferred right to recover the par value of preference shares in liquidation.

In October 1997 the Company registered shares in the form of 1 level American Depositary Receipts (ADR). Each ADR represents 2 shares of common stock of the Company. As at December 31, 2002 the Company has 4,615,919 ADR equal to 9,231,838 ordinary shares that represent 3.7% of ordinary shares and 2.8% of the Charter Capital. During 2003 the Company registered an additional 8,141,673 ADR equal to 16,283,346 ordinary shares, that gives an increase of 6.67% of ordinary shares or 4.98% of the Charter capital. As at December 31, 2003 the Company has 12,757,592 ADR equal to 25,515,184 ordinary shares that represent 10.37% of ordinary shares and 7.78% of the Charter Capital. Currently ADRs are traded on the Berlin and Frankfurt-on-Main Stock Exchanges and American over-the-counter market.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements (continued)

(in thousands, except share and per share amounts)

20. Share Capital (continued)

The Company’s shareholding structure as of December 31, 2003 was as follows:

	Ordinary shares		Preference shares		Total
	Number	%	Number	%	
OJSC “Svyazinvest”	124,633,745	50.67	–	0.00	124,633,745
Other legal entities	81,324,125	33.07	56,116,395	68.45	137,440,520
ADR Holders	25,515,184	10.37	–	0.00	25,515,184
Individuals	14,496,536	5.89	25,867,009	31.55	40,363,545
Total	245,969,590	100	81,983,404	100	327,952,994

21. Minority interest

As of December 31, 2002	<u>342,039</u>
Minority interest in net assets of acquired subsidiaries	202,853
Minority interest in net assets of subsidiaries disposed	(10,326)
Minority interest in net income of subsidiaries	244,664
Dividends to minority shareholders	<u>(2,758)</u>
As of December 31, 2003	<u>776,472</u>

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements (continued)

(in thousands, except share and per share amounts)

22. Loans and Borrowings

As of December 31, 2003 and 2002 loans and borrowings comprised the following:

	Interest rate	Maturity date	2003	2002
<u>Short-term loans and borrowings</u>				
<u>Bank loans:</u>				
Bank loans (Russian roubles)	12-23 %	2004	804,826	592,041
Bank loans (USD)	5%	2004	17,726	18,622
Bank loans (Euro)	9%	2004	-	4,681
Total bank loans			822,552	615,344
Bonds (Russian roubles)	1%	2004	13,187	-
<u>Vendor financing</u>				
Vendor financing (USD)	6-8%	2004	28,627	42,585
Vendor financing (Euro)	5-6%	2004	189,797	131,331
Vendor financing (Japanese Yens)	6%	2004	2,696	-
Total vendor financing			221,120	173,916
Promissory notes (Russian roubles)	13%	2004	400,000	-
Other loans	6-24%	2004	183,067	104,112
Total Short-term loans and borrowings			1,639,926	893,372
<u>Long-term borrowings</u>				
<u>Long-term bank loans</u>				
Long-term bank loans (Russian roubles)	11-16%	2004-2006	1,273,604	398,520
Long-term bank loans (Euro)	9%	2004-2006	97,453	143,365
Total bank loans			1,371,057	541,885
Bonds (Russian roubles)	13.67%	2006	1,000,000	-
<u>Vendor financing:</u>				
Vendor financing (Russian roubles)	6%	2004-2006	47,520	61,979
Vendor financing (USD)	6-8%	2004-2006	151,379	135,726
Vendor financing (Euro)	4-6%	2004-2006	359,947	476,413
Total vendor financing			558,846	674,118
Loans from related parties (OJSC “Svyazinvest”, Note 28)			-	62,526
Restructured connection fees from customers (Rubles)	1-7%	2004-2008	52,220	57,255
Other loans (Russian roubles)	5-7%	2004-2007	40,384	-
Less: Current portion of long-term loans and borrowings			(481,169)	(457,718)
Total long term borrowings			2,541,338	878,066

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements (continued)

(in thousands, except share and per share amounts)

22. Loans and Borrowings (continued)

As of December 31, 2003 short-term borrowings comprised 182,697 of interest payable (2002 – 53,031). This amount includes accrued coupon interest for bonds, totaling 91,071 and payable in February 2004.

As of December 31, 2003, long-term borrowings had the following maturity schedule:

Maturity date	Bank loans	Bonds and restructured connection fees	Vendor financing	Other	Total
2004	(152,925)	(532)	(303,902)	(23,810)	(481,169)
2005	(971,606)	(1,000)	(230,789)	(11,609)	(1,215,004)
2006	(246,526)	(1,002,000)	(24,155)	(3,031)	(1,275,712)
2007	–	(4,000)	–	(1,934)	(5,934)
2008		(44,688)			(44,688)
Total	(1,371,057)	(1,052,220)	(558,846)	(40,384)	(3,022,507)

Short-term Loans

Bank Loans

Short-term ruble borrowings mainly represent bank loans received for working capital financing purposes. Most of these loans are collateralized with telecommunications equipment.

Sberbank

During 2003, the Company entered into several agreements with Sberbank with the total amount of 463,798 outstanding as of December 31, 2003. Interest is accrued at 13-23% per annum. Maturity is June-August 2004. The loans are collateralized with fixed assets valued at 596,075.

International Moscow Bank

In November 2003, the Company entered into agreement with International Moscow Bank with the total amount of 201,009 outstanding as of December 31, 2003. Interest is accrued at 12% per annum. Maturity is November 2004. The loans are collateralized with fixed assets valued at 240,033.

Other bank loans

Other bank loans mainly represent bank loans received for working capital financing purposes. The interest rate varies from 9% to 23% per annum. The loans are not secured.

Notes to Consolidated Financial Statements (continued)

(in thousands, except share and per share amounts)

22. Loans and Borrowings (continued)*Short-term Loans (continued)***Vendor financing***Alkatel*

In 2001-2003 the Company entered into several agreements with Alkatel under which Alcatel delivered and installed telecommunication equipment. The related liability is denominated in Euro and US dollar. Part of these loans bears interest at 4-6 % per annum. The amount of non-interest bearing loans as at December 31, 2003 represent the present value of future payments under the agreements. Interest is accrued at a weighted average interest rate on the Company's interest bearing borrowings obtained in appropriate periods and denominated in Euro, which is approximately 6.8 % per annum.

IskraTel

The Company entered into agreements with IskraTel in the total amount of 2,651 thousand US dollar. The agreement is non-interest bearing. The liability as of December 31, 2003 is the present value of the future payments discounted at 5% per annum.

Huawei

The Company entered into agreements with Huawei in the total amount of 3,099 thousand US dollar. The agreement is non-interest bearing. The agreements do not provide for interest payments thus the amount of liability as at December 31, 2003 represents the present value of future payments. Interest is accrued at a weighted average interest rate on the Company's interest bearing borrowings obtained in appropriate periods (approximately 6.5%).

Promissory Notes*Vneshtorgbank*

The Company's short-term borrowings from Vneshtorgbank are represented by Promissory Notes issued in the amount of 400,000, which mature in 2004. Interest is accrued at 13% per annum.

Long-term Loans**Bank Loans***Sberbank*

Long-term loans from Sberbank mostly represent ruble credit lines under several agreements entered into during 2003 by the Company. The agreements terminate in 2005-2006. The loans under the agreements accrue interest at 14 % per annum. As of December 31, 2003, the outstanding amount was 707,677. The loans are collateralized with fixed assets valued at 748,537.

Notes to Consolidated Financial Statements (continued)

(in thousands, except share and per share amounts)

22. Loans and Borrowings (continued)

Long-term Loans (continued)

Bank Loans (continued)

International Moscow bank

Long-term borrowings from International Moscow Bank primarily represent a loan in the amount of 300,000 received in July 2003. The agreement terminates in January 2005. The loan under the agreement accrues interest payable at 12% per annum. As of December 31, 2003, the outstanding amount was 300,000. The loan is collateralized with fixed assets valued at 360,664.

Svyazinvest

In 1997-1998 Svyazinvest granted loans to the Company in the amount of 11,850 US dollars. The loans were provided for the working capital requirements and development of the rural telephone networks and was required to be settled in 2000. Following the crisis of 1998 and significant increase in the exchange rate of the US dollar to the ruble, re-payments on this agreement were ceased. As of December 31, 2003 the loans were fully repaid.

Bonds

In February 2003, the Company registered the issue of interest-bearing bearer's bonds, series VT-1, par value of 1 thousand Rubles. The bonds have 12 coupons. Payments against the first coupon are made on the 91st day from the date of issue; interest per other coupons are payable every subsequent 91st day. The coupon interest rate for the 1st and 2nd coupons is determined at 4.75 % per annum, for the 3rd and 4th coupons at 16.5% per annum, for the 5th–10th at 15% per annum, for the 11th and 12th at 13% per annum. The bonds mature 1,096 days from the date of issue in February 2006. The bonded loan is carried at the amortized cost with an effective rate of 13.67% per annum.

Notes to Consolidated Financial Statements (continued)

(in thousands, except share and per share amounts)

22. Loans and Borrowings (continued)

Long-term Loans (continued)

Vendor financing

Vnesheconombank

In 1995-1996, the Ministry of Finance of the Russian Federation (hereinafter, “the Ministry”) provided long-term financing to the Company to purchase telecommunications equipment from various foreign vendors. Vnesheconombank acted as the Company's lending agent on behalf of the Ministry. Agreements are denominated in Euro. The interest under these agreements is accrued at floating rate Plafond C, which in 2003 approximated 5.75-6.50 %, plus 2 % per annum. The loan is not collateralized.

Alkatel

The Company's long-term liabilities to Alcatel Sel AG are mainly represented by the amounts payable for the telecommunication equipment under contracts in 1997-2002. The amounts payable under these agreements are denominated in Euro and are repayable in equal semi-annual or quarterly installments till 2005. These agreements bear an interest rate of 4-6%. Certain Euro denominated loans are interest-free. The amount of this liability as at December 31, 2003 represents the present value of future payments under the agreements. Interest-free loans were discounted at the average interest rate on similar interest-bearing borrowings denominated in Euro. Equipment received under these agreements is pledged to the supplier until the final payment is made.

Ericsson Nikola Tesla

In 2001 the Company entered into several agreements with Ericsson Nikola Tesla in the total amount of 2,650 thousand US dollar, under which Ericsson Nikola Tesla delivered telecommunication equipment to the Company. The loans under the agreements accrue interest at 8% per annum.

Siemens AG

In 1997-2001 the Company entered into several agreements with Siemens AG totaling to 5,460 thousand Euro, under which Siemens AG delivered telecommunication equipment to the Company. The amounts payable under these agreements are denominated in Euro. The loans under the agreements accrue interest at 6% per annum.

Mashpriborkom

In 1997 the Company entered into several agreements with Mashpriborkom totaling to 2,948 thousand Euro, under which it delivered telecommunication equipment to the Company. The loan under the agreement accrues interest at 11% per annum.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements (continued)

(in thousands, except share and per share amounts)

23. Finance Lease Obligations

The Company has finance lease contracts for telecommunication equipment. Future minimum lease payments under finance lease contracts together with the present value of the net minimum lease payments as of December 31, 2003 and 2002 are as follows:

	2003		2002	
	Minimum payments	Present value of payments	Minimum payments	Present value of payments
Current portion	510,111	321,109	260,157	193,054
2 to 5 years	717,399	520,394	288,691	222,846
Total minimum lease payments	1,227,510	841,503	548,848	415,900
Less amounts representing finance charges	(386,007)		(132,948)	
Present value of minimum lease payments	841,503	841,503	415,900	415,900

In 2003 and 2002, the Company’s primary lessors were OJSC “RTC-Leasing” and LLC “Promsvyazleasing”. In 2003, the effective interest rate on leasing liabilities ranged from 21% to 39% per annum (2002 - from 20% to 40%).

In accordance with agreements concluded with OJSC “RTC-Leasing”, the lessor is entitled to adjust the lease payments schedule subject to certain changes in the economic environment, in particular, changes in the refinancing rate of the Central Bank of the Russian Federation.

24. Accounts Payable and Accrued Liabilities

As of December 31, 2003 and 2002, the Company’s accounts payable and current liabilities comprised the following:

	2003	2002
Trade accounts payable	314,479	316,837
Advances received from subscribers	449,456	331,581
Accounts payable for capital investments	846,459	489,692
Salaries and wages payable	314,291	198,792
Accounts payable on acquisition of subsidiaries	184,042	5,385
Other accounts payable	245,781	200,255
Total	2,354,508	1,542,542

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements (continued)

(in thousands, except share and per share amounts)

25. Taxes and Payroll Related Obligations

As of December 31, 2003 and 2002, the Company had the following taxes payable:

	2003	2002
Value-added tax	459,286	386,990
Income tax	6,913	129,853
Property tax	44,763	39,125
Sales tax	41,339	45,096
Unified social tax	125,239	45,918
Other	64,605	50,783
Total	742,145	697,765

26. Pension Plans and Employee Benefits

In 2003 the Company made various payments to employees in addition to salary. These payments generally represent financial aid to the Company’s employees with limited abilities and bonuses to employees, which had made no breaches of internal policies during the last fiscal year. Such benefits were included in salary, benefits, salary taxes and other social expenditures in the accompanying consolidated statements of operations for the year ended December 31, 2003 and totaled 74,454 (2002 – 121,000).

In addition to statutory pension benefits, the Company also contributes to defined benefit plans which cover most of its employees. Non-government pension fund “Telecom-Soyuz”, which is related to the Company (see Note 28 “Related Parties”), maintains the plan. The plans provide for payment of retirement benefits starting from statutory retirement age, which is currently 55 for women and 60 for men. The benefits are based on a formula recognizing minimal statutory pension, length of service both in the Company and in the telecommunications industry, as well as final average earnings and position in the Company at retirement. The benefits are not vesting and are subject to the employee retiring from the Company on or after the above-mentioned ages. The Company makes contributions to the pensions funds as a set percentage of the employees’ salaries or in the amount set forth in the agreement with the pension fund subject to a specific pension arrangement.

The Company has not made an actuarial determination of its obligation under these agreements and hence has not recorded its obligations or made disclosures required under IAS 19, “Employee Benefits”, pertaining to the value of obligations and assets of the plan as of December 31, 2003 and 2002.

Notes to Consolidated Financial Statements (continued)

(in thousands, except share and per share amounts)

27. Commitments and Contingencies

General Contingencies

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

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

Tax Laws and Regulations

Legislation and regulations regarding taxation and foreign currency transactions in Russia continue to evolve as the government manages the transformation from a command to a market-oriented economy.

During 2002, the Russian Federation enacted a new tax code with significant modifications from the prior law.

The various legislation and regulations are not always clearly written and their interpretation is subject to the opinions of the local, regional and national tax authorities, the Central Bank and Ministry of Finance. Instances of inconsistent opinions are not unusual.

The current regime of penalties and interest related to reported and discovered violations of Russia’s laws, decrees and related regulations is severe. Interest (at the Central Bank of RF official rates) and fines are levied when an understatement of tax liability is discovered. As a result, penalties and interest can result in amounts that are multiples of any unreported taxes.

The Company believes that it has paid or accrued all taxes that are applicable. Where practice concerning the provision of taxes was unclear, the Company has accrued tax liabilities based on management’s best estimate. The Company’s policy is to accrue for contingencies in the accounting period in which a loss is deemed probable and the amount is reasonably determinable. No such accruals have been made as of December 31, 2003.

Because of the uncertainties associated with the Russian tax and legal systems, the ultimate amount of taxes, penalties and interest assessed, if any, may be in excess of the amount expensed to date and accrued as of December 31, 2003.

Notes to Consolidated Financial Statements (continued)

(in thousands, except share and per share amounts)

27. Commitments and Contingencies (continued)

Insurance Coverage

The Russian insurance industry is in a developing state and many forms of insurance protection common in other parts of the world are not yet generally available. During 2003, the Company did not maintain insurance coverage on a significant part of its property, plant and equipment asset bases, business interruption, or third party liability in respect of property or environmental damage arising from accidents on the Company’s property or relating to the Company’s operations. Until the Company obtains adequate insurance coverage, there is a risk that the loss or destruction of certain assets could have a material adverse effect on the Company’s operations and financial position. As of December 31, 2003, the Company’s insured fixed assets at gross book value amounted to approximately 10.6 billion roubles.

Litigation, Claims and Assessments

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

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

Telecommunication Reforms

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 new law may increase the degree of regulators’ oversight over the Company’s operations and until such time as appropriate regulations consistent with the new law are promulgated, there will be a period of confusion and ambiguity as regulators interpret the legislation.

Under the new law, the Company is obliged to provide services under similar circumstances and equal conditions for connecting telecommunications networks and for carrying traffic from communications operators rendering similar services and to render connection services and the services involved in carrying traffic to these operators under the same terms and of the same standard, like for its own structural subdivisions and for affiliated parties.

According to the new telecommunication law, the individual subscriber has an option for local service to be paid based on subscription or by-the-minute payment system.

Management cannot predict with any certainty to what degree (if at all) the new law will affect the Company’s operations.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements (continued)

(in thousands, except share and per share amounts)

27. Commitments and Contingencies (continued)

Capital Commitments

Oracle E-business Suite implementation

The Company contracted to invest approximately 5,360 thousand US dollars into installation of Oracle E-business Suite in 2004.

Guarantees issued

As of December 31, 2003 the Company had issued guarantees totalling 1,236,657 (December 31, 2002 – 631,000) with regard to bank loans mainly drawn by OJSC “RTC-Leasing” (see also Note 23 “Finance Lease Obligations”). On October 23, 2002 the Company issued a guarantee for a loan received by OJSC “RTC-Leasing” from Sberbank under a non-revolving credit line facility. Guarantee outstanding as of December 31, 2003 amounted to 437,926. On September 9, 2003 the Company issued another guarantee for a loan received by OJSC “RTC-Leasing” from Sberbank in the amount of 790,681. Both guaranteed loans were received by OJSC “RTC-Leasing” to finance expenditures related to lease agreements with the Company. The repayment of these loans should be performed in equal instalments during 2004 – 2008. As of December 31, 2003 Sberbank did not claim any overdue repayments of the loans. The Company’s management does not expect occurrence of any material obligations related to these guarantees.

Capital Investments

At December 31, 2003 the Company has commitments of 378,571 (2002 – 380,828) for capital investments into modernization and expansion of its network, including finance lease obligations in the amount of 202,297 (2002 – 225,273)

28. Related Parties

OJSC “Svyazinvest”

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

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

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements (continued)

(in thousands, except share and per share amounts)

28. Related Parties (continued)

OJSC “Svyazinvest” (continued)

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

During 2003 the Company repaid two loans to OJSC “Svyazinvest” in the amount of 62,526 (see also Note 22 “Loans and Borrowings”).

OJSC “Rostelecom”

OJSC “Rostelecom”, a majority owned subsidiary of OJSC “Svyazinvest”, is the primary provider of domestic long distance and international telecommunications services in the Russian Federation. The annual expense associated with traffic carried by OJSC “Rostelecom” and terminated outside of the Company’s network is stated as interconnection charges (see also Note 2 “Summary of Significant Accounting Policies”). Further, OJSC “Rostelecom” uses the Company’s network to provide incoming long-distance and international traffic to its subscribers and partner operators. Transactions undertaken by the Company with OJSC “Rostelecom” reported in the accompanying consolidated financial statements as at December 31, 2003 and 2002 and for the years then ended were as follows:

	<u>2003</u>	<u>2002</u>
Expenses on traffic transfer and rent of channels from Rostelecom	1,450,821	1,019,177
Revenue received from Rostelecom	380,513	9,976
Accounts payable to Rostelecom as at the year-end	199,897	174,803

OJSC “RTC-Leasing”

OJSC “RTC-Leasing” purchases telecommunication equipment from domestic and foreign suppliers and leases the equipment. In October 2003, OJSC “Rostelecom”, which owned 27% of ordinary shares of OJSC “RTC-Leasing” and exercised financial and operational control over the company’s activities, sold all its shares of OJSC “RTC-Leasing” to a third party.

As a result of this transaction, starting from December 1, 2003 OJSC “RTC-Leasing” is not considered to be the Company’s related party and is not included into the Group of companies owned by OJSC “Svyazinvest”.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements (continued)

(in thousands, except share and per share amounts)

28. Related Parties (continued)

OJSC “RTC-Leasing” (continued)

The Company’s obligations under capital leases to OJSC “RTC-Leasing” as at December 31 are presented below:

	2003		2002	
	Minimum payments	Present value of payments	Minimum payments	Present value of payments
Current portion	317,042	179,804	72,217	42,274
2 to 5 years	629,414	442,640	163,108	111,896
Total minimum lease payments	946,456	622,444	235,325	154,170
Less amounts representing finance charges	(324,012)		(81,155)	
Present value of minimum lease payments	622,444	622,444	154,170	154,170

The Company’s obligations under capital leases to OJSC “RTC-Leasing” as at December 31, 2003 comprised 74% (2002 – 37%) of the Company’s total obligations for finance leases (see Note 23 “Finance Lease Obligations”).

Transactions with Government Organizations

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

Government subscribers accounted for approximately 39.6% of gross trade accounts receivable as of December 31, 2003 (2002 – 31.9%). Amounts outstanding from government subscribers, including receivables for allowances for subscribers with reduced tariffs, as of December 31, 2003, amounted to 744,802 (2002 – 320,116).

Associates

The Company also provided services to its associates, including connection to public network and rent of space for equipment and premises.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements (continued)

(in thousands, except share and per share amounts)

28. Related Parties (continued)

Associates (continued)

The Company’s consolidated financial statements included the following amounts as of December 31, 2003 and 2002:

	<u>2003</u>	<u>2002</u>
Accounts receivable from associates	4,257	10,691
Accounts payable to associates	8,790	851
Sales to associates	56,687	43,506
Purchases from associates	12,892	8,266

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

Non-commercial partnership Center for Research of the Problems in Development of Telecommunications (hereinafter “the Partnership”) is an entity related to OJSC “Svyazinvest”. The Company has an agreement with the Partnership, under which it provides financing for mutually beneficial projects undertaken by the Partnership on behalf of the Company and other subsidiaries and associates of OJSC “Svyazinvest”. Payments to the Partnership included in other operating expenses in the accompanying consolidated statement of operations for the year ended December 31, 2003 amounted to 135,804 (2002 – 104,233).

NPF “Telecom-Soyuz”

The Company has a number of pension agreements with NPF “Telecom-Soyuz” (see also Note 26 “Pension Plans and Employee Benefits”). Payments to this pension fund in 2003 amounted to 68,686 (2002 – 44,299).

Compensation of the Company’s management

In 2003, compensation to the members of the Company’s Board of Directors totaled 27,107 (2002 – 7,903).

29. Financial Instruments

Fair value

The management believes that the value at which the financial instruments are carried in the accompanying consolidated balance sheet as of December 31, 2003 and 2002, approximates their fair value.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements (continued)

(in thousands, except share and per share amounts)

29. Financial Instruments (continued)

Interest rate risk

The following table presents the carrying amount by maturity of the Company’s financial instruments that are exposed to interest rate risk:

Year ended December 31, 2003:

	< 1 year	1-5 years	> 5 years	Total
<i>Fixed rate</i>				
Short-term loans and borrowings	1,498,379	-	-	1,498,379
Current portion of long-term borrowings	338,335	-	-	338,335
Long-term loans and borrowings	-	2,421,071	42,688	2,463,759
Finance lease obligations	321,109	520,394	-	841,503
<i>Floating rate</i>				
Short-term loans and borrowings	141,547	-	-	141,547
Current portion of long-term borrowings	142,834	-	-	142,834
Long-term loans and borrowings	-	77,579	-	77,579

Year ended December 31, 2002:

	< 1 year	1-5 years	> 5 years	Total
<i>Fixed rate</i>				
Short-term loans and borrowings	779,586	-	-	779,586
Current portion of long-term borrowings	422,294	-	-	422,294
Long-term loans and borrowings	-	698,294	42,688	740,982
Finance lease obligations	193,054	222,846	-	415,900
<i>Floating rate</i>				
Short-term loans and borrowings	113,786	-	-	113,786
Current portion of long-term borrowings	35,424	-	-	35,424
Long-term loans and borrowings	-	137,084	-	137,084

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

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

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements (continued)

(in thousands, except share and per share amounts)

30. Subsequent Events

Dividends

On June 22, 2004, the general meeting of the Company’ shareholders approved dividends for 2003 in the amount of 2.4510 Rubles per preferred share and 0.9186 Rubles per ordinary share. Total dividends declared amounted to 200,941 and 225,948 for preferred and ordinary shares, respectively. Preferred dividends were accrued as of December 31, 2003 based on the preferred shareholders’ minimum dividend rights. Ordinary dividends were accrued when declared in 2004.

Finance lease agreements with OJSC “RTC-Leasing”

In 2004, the Company entered into new finance lease agreements with OJSC “RTC-Leasing”. The aggregate cost of equipment leased under these agreements, inclusive of installation and other capitalizable services’ costs, approximated 529,208, with the respective non-discounted future cash flows of approximately 608,407.

Bank Loan agreements with Sberbank and Nomos-Bank

In March - June 2004, OJSC “VolgaTelecom” entered into several loan agreements with Sberbank and Nomos-Bank for the aggregate amount of 1,263,500. The loans mature in 2005-2008. The interests on the bank loans are accrued at the rates of 11-13.5 % per annum. The loans are secured with telecommunications equipment valued at 1,350,994.

On March 11, 2004 the Board of Directors approved a loan contract for non-revolving credit line facility with Sberbank bearing annual interest rate of 11% for 1 year. The loan in amount of 400,500 is collateralized with telecommunication equipment in the amount of 445,636.

On May 18, 2004 the Board of Directors approved a loan contract for non-revolving credit line facility with Sberbank totaling 1,480,000 and bearing annual interest rate of 13,5% for 5 years. The credit line is collateralized with telecommunication equipment in the amount of 1,646,580.

Acquisitions

LLC “Izhcom”

On February 11, 2004 the Board of Directors approved the decision to purchase the 49% minority interest in LLC “Izhcom”. LLC “Izhcom” provides data transmission and telematic services in the Republic of Udmurtia. On August 19, 2004 the Board of Directors decided to merge activities of LLC “Izhcom” with those of the Company.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements (continued)

(in thousands, except share and per share amounts)

30. Subsequent Events (continued)

Acquisitions (continued)

CJSC “Transsvyaz”

In accordance with the decision of the Board of Directors of April 15, 2004 the Company purchased an additional 40% of CJSC “Transsvyaz” for 3,975. CJSC “Transsvyaz” provides local telephone network services and digital network development research services.

CJSC “Ulianovsk-GSM”

On May 12, 2004 the Board of Directors approved the decision to increase the Company’s share in CJSC “Ulianovsk-GSM” by 9% by acquiring 9 shares for 6,900 each, totalling 62,100. CJSC “Ulianovsk-GSM” provides cellular services in GSM-900 standard. The purchase of 4% was completed on July 12, 2004.

Disposals of investments

CJSC “Tsifrovye Seti Udmurtii-900”

On February 27, 2004 the Board of Directors approved the sale of the Company’s 49% share in CJSC “Tsifrovye Seti Udmurtii – 900” to OJSC “Mobile TeleSystems” for 6,400 thousand USD. CJSC “TSU-900” provides cellular services in GSM-900 standard on the territory of the Republic of Udmurtia.

Sale of NMT operators

On May 12, 2004 the Company’s Board of Directors approved the decision to sell ownership interests held by the Company in the following companies as of December 31, 2003:

Name	Activity	Share in investee,	
		%	Sale price
LLC “Vyatskaya sotovaya svyaz”	Cellular services	51	1,642
LLC “Udmurtskie sotovye seti-450”	Cellular services	100	4,680
CJSC “Sotovaya svyaz Mordovii”	Cellular services	60	31
CJSC “Saratovskie systemi sotovoi svyazi”	Cellular services	15	235
CJSC “Sotel-NN”	Cellular services	20	612
Total			7,200

The Company sold its NMT-450 operators to LLC “MS-Direkt”. Full prepayment for these companies was received on June 30, 2004.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements (continued)

(in thousands, except share and per share amounts)

30. Subsequent Events (continued)

Constitutional Court Resolution

In 2004, Resolution No. 169-O of the Constitutional Court of the Russian Federation dated April 8, 2004 has become publicly available. The resolution has the possible effect of deferring the timing in which companies are able to offset input VAT to the extent the creation of such VAT is deemed to be attributable to the utilization of borrowed funds. In the event local taxing authorities would assert and successfully defend such an interpretation, the result could have a material adverse impact on the Company's financial condition. As of the date of this report, management is unable to predict the outcome of this uncertainty.

Decrease of VAT rate

Commencing from January 1, 2004, the VAT rate was decreased from 20% to 18%.