

**Open Joint Stock Company
“VolgaTelecom”**

Consolidated Financial Statements

*For the year ended December 31, 2005
with Independent Auditor's Report*

OJSC “VolgaTelecom”
Consolidated Financial Statements
For the year ended December 31, 2005

Contents

Independent Auditors’ Report	1
Consolidated Financial Statements	
Consolidated Balance Sheet	3
Consolidated Statement of Operations	4
Consolidated Statement of Cash Flows	5
Consolidated Statement of Changes in Equity	6
Notes to Consolidated Financial Statements	7

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, 2005, and the related consolidated statements of operations, cash flows and changes in shareholders' equity for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.
2. Except as discussed in paragraphs 3 and 4, we conducted our audit in accordance with International Standards on Auditing 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 2 "Basis of Presentation of the Financial Statements" and Note 5 "Property, Plant and Equipment", the Company transitioned to International Financial Reporting Standards (IFRS) at January 1, 2003 and applied an exemption in IFRS 1, "First-time Adoption of International Financial Reporting Standards", which permits to measure property, plant and equipment at the date of transition to IFRS at fair value and use that fair value as deemed cost. However, we were not able to satisfy ourselves as to whether the carrying amounts of property, plant and equipment as at January 1, 2003 were representative of fair value. Accordingly, we were unable to determine whether the carrying value of property, plant and equipment as of December 31, 2005 and 2004 complies with the requirements of IFRS. Further, we were unable to satisfy ourselves as to the related (i) depreciation expense for the years presented and (ii) the deferred tax balances as of December 31, 2005 and 2004 and deferred tax expense for the years presented.
4. As described in Note 2 "Basis of Presentation of the Financial Statements" and Note 22 "Pensions and Other post-employment benefit plans", the Company provides certain long term benefits to its employees. The Company engaged an independent actuary to estimate its obligations regarding such benefits as of December 31, 2005, 2004 and 2003. Management did not provide us with sufficient support for the actuarial assumptions and significant underlying data used. We were therefore unable to satisfy ourselves with respect to the pension obligation and other post-employment benefit plans as of December 31, 2005, 2004 and 2003, the related expense for the defined benefit pension and other post-employment plans for the years presented, and the related disclosures.

5. In our opinion, except for the effects on the financial statements of such adjustments, if any, which might have been determined to be necessary had we been able to satisfy ourselves as to the matters referred to in paragraphs 3 and 4 above, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of OJSC “VolgaTelecom” as of December 31, 2005, and the consolidated results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

May 31, 2006

OJSC “VolgaTelecom”
Consolidated Balance Sheet
As of December 31, 2005
(in thousands roubles)

	Notes	2005	2004
ASSETS			
Non-current assets			
Property, plant and equipment, net	5	28,525,610	25,603,506
Intangible assets and goodwill, net	6	2,745,615	2,167,468
Investments in associates	8	119,980	110,096
Long-term investments, net	9	24,910	11,252
Long-term accounts receivable and other assets	10	20,835	21,591
Long-term advances given	11	749,055	227,798
Deferred income tax asset	27	27,049	24,814
Total non-current assets		32,213,054	28,166,525
Current assets			
Inventories, net	12	544,087	859,609
Accounts receivable, net	13	1,296,011	1,137,874
Other current assets	14	1,577,657	1,694,769
Cash and cash equivalents	15	1,338,713	422,185
Total current assets		4,756,468	4,114,437
TOTAL ASSETS		36,969,522	32,280,962
EQUITY AND LIABILITIES			
Equity attributable to equity holders of the parent			
Share capital	17	3,853,690	3,853,690
Unrealized gain on available-for-sale investments		2,134	800
Retained earnings		14,507,125	12,489,617
Total equity attributable to equity holders of the parent		18,362,949	16,344,107
Minority interest		415,614	377,213
Total equity		18,778,563	16,721,320
Non-current liabilities			
Long-term borrowings	18	7,589,666	4,256,346
Long-term finance lease obligations	19	727,768	698,769
Pension Liabilities	22	827,392	709,434
Deferred revenue		331,618	332,491
Deferred income tax liability	27	1,336,072	1,021,603
Total non-current liabilities		10,812,516	7,018,643
Current liabilities			
Accounts payable, accrued expenses and advances received	20	2,574,536	2,592,766
Payables to Rostelecom		108,100	110,965
Income tax payable		76,541	114,100
Other taxes payable	21	812,712	730,950
Dividends payable		63,641	28,487
Short-term borrowings	18	683,741	2,801,307
Current portion of long-term borrowings	18	2,699,872	1,816,704
Current portion of long-term finance lease obligations	19	359,300	345,720
Total current liabilities		7,378,443	8,540,999
Total liabilities		18,190,959	15,559,642
TOTAL EQUITY AND LIABILITIES		36,969,522	32,280,962

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

OJSC “VolgaTelecom”

Consolidated Statement of Operations

For the year ended December 31, 2005

(in thousands roubles, except per share amounts)

	Notes	2005	2004
Revenues	23	23,756,233	20,966,543
Wages, salaries, other benefits and payroll taxes		(7,857,798)	(6,892,515)
Depreciation and amortization	5,6	(3,417,659)	(2,584,675)
Materials, repairs and maintenance, utilities		(2,185,768)	(1,787,512)
Taxes other than income tax		(550,307)	(461,666)
Interconnection charges		(2,634,267)	(2,472,250)
Provision for impairment of receivables	13	(12,020)	(599,653)
Loss on disposal of property, plant, and equipment		(103,699)	(78,269)
Other operating expenses, net	24	(2,274,446)	(2,010,144)
Operating profit		4,720,269	4,079,859
Share of result of associates, net	8	20,713	72,549
Interest expense, net	25	(843,532)	(643,958)
Gain on sale of subsidiaries, associates and other investments	26	41,842	88,144
Foreign exchange gain (loss), net		53,118	(14,291)
Profit before income tax		3,992,410	3,582,303
Income tax expense	27	(1,391,621)	(1,167,257)
Profit for the year		2,600,789	2,415,046
Attributable to:			
Equity holders of the parent		2,562,060	2,321,983
Minority interests		38,729	93,063
		2,600,789	2,415,046
Earnings per share			
- basic and diluted, for profit for the year attributable to equity holders of the parent	28	7.81	7.08

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

OJSC “VolgaTelecom”

Consolidated Cash Flow Statement

For the year ended December 31, 2005

(in thousands roubles)

	Notes	2005	2004
Cash flows from operating activities:			
Profit before income tax		3,992,410	3,582,303
Adjustments for:			
Depreciation and amortization	5,6	3,417,659	2,584,675
Loss on disposal of property, plant and equipment		103,699	78,269
Provision for impairment of receivables	13	12,020	599,653
Provision for obsolescence of inventory	12	2,874	-
Share of result of associates	8	(20,713)	(72,549)
Gain from sale of subsidiaries, associates and other investments	26	(41,842)	(88,144)
Interest expense, net	25	843,532	643,958
Foreign exchange gain (loss), net		(53,118)	14,291
Operating cash flows before working capital changes		8,256,521	7,342,456
Increase in accounts receivable		(162,113)	(662,830)
Decrease (increase) in other current assets		118,543	(621,181)
Decrease (increase) in inventories		315,812	(352,798)
Increase in accounts payable and accrued expenses		343,732	542,094
Increase in taxes payable other than income tax		81,762	104,839
Increase in pension obligations		117,958	157,014
Cash flows generated from operations		9,072,215	6,509,594
Interest paid		(853,373)	(535,186)
Income tax paid		(1,113,867)	(1,005,204)
Net cash flows from operating activities		7,104,975	4,969,204
Cash flows from investing activities:			
Purchase of property, plant and equipment		(5,452,965)	(6,577,511)
Purchase of intangible assets		(459,114)	(124,053)
Purchase of Oracle E-Business Suite software		(140,973)	(83,727)
Purchase of Amdocs Billing software		(74,714)	-
Proceeds from sales of property, plant and equipment		117,211	99,245
Purchase of subsidiaries, net of cash acquired		(50,986)	(249,891)
Disposal of subsidiaries, net of cash disposed		3,383	177,686
Purchase of investments and other assets		(63,694)	-
Proceeds from disposal of investments and other financial assets		51,141	222,309
Interest received		22,942	9,825
Dividends received		1,528	38,232
Net cash flows used in investing activities		(6,046,241)	(6,487,885)
Cash flows from financing activities:			
Proceeds from borrowings		6,403,784	7,542,718
Repayment of borrowings		(9,240,037)	(4,007,279)
Proceeds from debt securities issued		5,259,438	37,428
Repayment of debt securities		(6,221)	-
Proceeds from promissory notes		-	396,160
Repayment of promissory notes		-	(832,037)
Repayment of finance lease obligations		(777,703)	(485,308)
Repayment of vendor financing obligations		(772,286)	(613,289)
Repayment of promissory notes for Amdocs Billing Software		(498,528)	-
Proceeds from other non-current liabilities		(927)	-
Dividends paid to equity holders of the parent		(509,398)	(424,811)
Dividends paid to minority		(328)	-
Net cash flows from financing activities		(142,206)	1,613,582
Net increase in cash and cash equivalents		916,528	94,901
Cash and cash equivalents at the beginning of the year		422,185	327,284
Cash and cash equivalents at the end of the year		1,338,713	422,185

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

OJSC “VolgaTelecom”
Consolidated Statement of Changes in Equity
For the year ended December 31, 2005
(in thousands roubles)

		Attributable to equity holders of the parent								
Notes	Share capital		Retained earnings (before adjustment)	Correction of error	Retained Earnings (adjusted)	Unrealized gain on available-for-sale investments	Total	Minority interests	Total equity	
	Preference shares	Ordinary shares								
Balance at December 31, 2003	2	963,366	2,890,324	11,205,113	(552,420)	10,652,693	-	14,506,383	345,803	14,852,186
Profit for the year		-	-	2,478,997	(157,014)	2,321,983	-	2,321,983	93,063	2,415,046
Dividends to equity holders of parent		-	-	(426,889)	-	(426,889)	-	(426,889)	-	(426,889)
Minority interests arising on acquisition of subsidiary		-	-	-	-	-	-	-	3,113	3,113
Acquisition of minority interests in existing subsidiaries		-	-	(57,370)	-	(57,370)	-	(57,370)	(28,011)	(85,381)
Disposal of minority interests due to disposal of subsidiaries		-	-	-	-	-	-	-	(31,881)	(31,881)
Dividends of subsidiaries to minority shareholders		-	-	-	-	-	-	-	(4,874)	(4,874)
Balance at December 31, 2004	2	963,366	2,890,324	13,199,851	(709,434)	12,490,417	-	16,344,107	377,213	16,721,320
Effect of change in accounting policies	2	-	-	(800)	-	(800)	800	-	-	-
Balance at December 31, 2004 (adjusted)	2	963,366	2,890,324	13,199,051	(709,434)	12,489,617	800	16,344,107	377,213	16,721,320
Profit for the year		-	-	2,680,018	(117,958)	2,562,060	-	2,562,060	38,729	2,600,789
Dividends to equity holders of parent		-	-	(544,552)	-	(544,552)	-	(544,552)	-	(544,552)
Unrealized gain on available-for-sale investments		-	-	-	-	-	1,334	1,334	-	1,334
Dividends of subsidiaries to minority shareholders		-	-	-	-	-	-	-	(87)	(87)
Disposal of minority interests due to disposal of subsidiaries		-	-	-	-	-	-	-	(241)	(241)
Balance at December 31, 2005		963,366	2,890,324	15,334,517	(827,392)	14,507,125	2,134	18,362,949	415,614	18,778,563

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

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

For the year ended December 31, 2005

(in thousands roubles)

1. General Information

Authorization of Accounts

The consolidated financial statements of OJSC “VolgaTelecom” and its subsidiaries – (hereinafter “the Company”) for the year ended December 31, 2005 were authorized for issue by the General Director and the Chief Accountant of the Company on May 31, 2006.

The Company

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

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

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

Open joint-stock company Svyazinvest, controlled by the Russian Government, as a holding company, as of December 31, 2005 owned 51% of the Company’s ordinary voting stock.

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

Presentation of Financial Statements

The consolidated financial statements of OJSC “VolgaTelecom” are prepared based on standalone financial statements of the parent and its subsidiaries and associates prepared under unified accounting policy.

The measurement and presentation currency of the Company is the Russian Rouble, which is the national currency of the Russian Federation.

The consolidated financial statements of the Company are presented in thousands of Russian Roubles.

Tariff Setting

Tariffs relating to intercity traffic are regulated by the government and tariffs for international traffic are regulated by OJSC “Rostelecom” which is controlled by OJSC “Svyazinvest” holding.

In 2005 the Company revised its tariffs for telephone services with the aim to decrease the effect of cross-subsidization between domestic long-distance and local services by changing the tariffs for local telephone calls.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

1. General Information (continued)

Tariff Setting (continued)

In general, the Company increased tariffs in 2005 and 2004 as follows:

Customer Group	Urban areas, %		Rural areas, %	
	2004	2005	2004	2005
Residential	26.9	20.7	29.7	20.7
Corporate	30.1	15.7	30.1	15.7

New regulations supporting the implementation of the Federal Law on Communications are effective from January 1, 2006. These regulations affect the principles of provision of fixed line telecommunication services and change licensing requirements to the Company (see also Note 34 on tariffs for telecommunication services).

Liquidity and Financial Resources

As of December 31, 2005, the Company’s current liabilities exceeded its current assets by 2,621,975 (December 31, 2004 – 4,426,562). As a result, there may be some doubts about the Company’s ability to attract further financing and to pay its existing debts as they fall due.

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, bonds, vendor financing, and finance leases.

If needed, management believes that certain projects may be deferred or curtailed in order to fund the Company’s current operating needs. Management expects to continue to be able to delay payment for certain operating costs to manage its working capital requirements if necessary.

Through 2006, the Company anticipates funding from a) cash generated from operations; b) bonds placement in the domestic market; c) financing from domestic and international lending institutions.

2. Basis of Presentation of the Financial Statements

Basis of Preparation

These financial statements have been prepared and presented in accordance with International Financial Reporting Standards (“IFRS”).

These financial statements are prepared based on the statutory financial statements in accordance with the Regulations on Accounting and Reporting of the Russian Federation, with adjustments and reclassifications recorded for the purpose of fair presentation of ending balances, results of operations and cash flows in accordance with IFRS.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

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

Basis of Preparation (continued)

These 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 be required if 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.

The consolidated financial statements have been prepared under the historical cost convention except as disclosed in the accounting policies below.

The Company has transitioned to IFRS as of January 1, 2003 using the provisions of IFRS 1, “First-time Adoption of International Financial Reporting Standards”, which is effective for periods starting on or after January 1, 2004. IFRS 1 applies to first-time adopters of IFRS including companies that previously applied some, but not all IFRS, and disclosed this fact in its most recent previous financial statements.

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

Management estimates that the carrying value of all of the Company’s property, plant and equipment is broadly comparable to their fair values. However, management intends to engage an independent appraiser to support these fair values and as a result, the reported carrying amount of property, plant and equipment may be adjusted. It is expected that the appraisal will be completed in the near future. Also management engaged an actuary to evaluate pension liabilities of the Company and, respectively, pension liabilities may be adjusted upon completion of the evaluation.

The Russian economy was considered hyperinflationary until prior to January 1, 2003. As such, the Company applied IAS 29 “Financial Reporting in Hyperinflationary Economies” by restating non-monetary items, including components of equity (except for the property, plant and equipment, for which fair values as at January 1, 2003 have been used as deemed cost) to the measuring units current at January 1, 2003 by applying the relevant inflation indices to the historical cost. These restated values were used as a basis for accounting in subsequent periods.

The accounting policies adopted are consistent with those of the previous financial year except that the Company has adopted those new/revised standards mandatory for financial years beginning on or after January 1, 2005.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

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

Basis of Preparation (continued)

The changes in accounting policies result from adoption of the following new or revised standards:

- IFRS 2 “Share-Based Payment”;
- IFRS 5 “Non-current Assets Held for Sale and Discontinued Operations”;
- IAS 1 (revised) “Presentation of Financial Statements”;
- IAS 2 (revised) “Inventories”;
- IAS 8 (revised) “Accounting Policies, Changes in Accounting Estimates and Errors”;
- IAS 10 (revised) “Events after the Balance Sheet Date”;
- IAS 16 (revised) “Property, Plant and Equipment”;
- IAS 17 (revised) “Leases”;
- IAS 24 (revised) “Related Party Disclosures”;
- IAS 27 (revised) “Consolidated and Separate Financial Statements”;
- IAS 28 (revised) “Investments in Associates”;
- IAS 31 (revised) “Interests in Joint Ventures”;
- IAS 32 (revised) “Financial Instruments: Presentation and Disclosure”;
- IAS 33 (revised) “Earnings per Share”;
- IAS 39 (revised) “Financial Instruments: Recognition and Measurement”.

The principal effects of these changes in policies are discussed below.

IAS 1 (revised) “Presentation of Financial Statements” and IAS 27 “Consolidated and Separate Financial Statements”

Minority interests in net assets of the Company’s subsidiaries are presented within equity, separately from the parent shareholders’ equity. Previously, minority interests were presented separately from liabilities and equity in the Company’s consolidated balance sheet.

IAS 39 “Financial Instruments: Recognition and Measurement” (amended 2004)

The gains and losses on re-measurement of financial assets available-for-sale to fair value are recognized as a separate component of equity. A gain or loss on an available-for-sale financial asset is recognized directly in equity (including a reversal of impairment losses for equity instruments), through the statement of changes in equity, except for impairment losses and foreign exchange gains and losses, until the financial asset is derecognized, at which time the cumulative gain or loss previously recognized in equity is recognized in profit or loss. However, interest calculated using the effective interest method is recognized in profit or loss. Dividends on an available-for-sale equity instrument are recognized in profit or loss when the Company’s right to receive payment is established.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

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

Basis of Preparation (continued)

IFRSs and IFRIC Interpretations not yet effective

The Company has not applied the following IFRSs and IFRIC Interpretations that have been issued but are not yet effective:

- IAS 19 (amended 2004) “Employee Benefits”;
- IAS 39 (amended 2005) “Financial Instruments: Recognition and Measurement”;
- IFRS 6 “Exploration for and Evaluation of Mineral Resources”;
- IFRS 7 “Financial Instruments: Disclosures”;
- IFRIC 4 “Determining whether an Arrangement contains a Lease”;
- IFRIC 5 “Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds”.

The Company expects that the adoption of the pronouncements listed above will have no significant impact on the Company’s financial statements in the period of initial application.

Management Estimates

The preparation of financial statements requires management of the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The most significant estimates with regard to those financial statements relate to the valuation and useful lives of property, plant and equipment, intangible assets, deferred taxation, provision for bad debt reserve and pension liabilities as discussed in Notes 5, 6, 27, 13 and 22.

Estimation Uncertainty

The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

Impairment of Goodwill

The Company determines whether goodwill and intangible assets not yet available for use are impaired at least on an annual basis. This requires an estimation of the value in use of the cash-generating units to which the goodwill is allocated. Estimating the value in use requires the Company to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows. The carrying amount of goodwill at December 31, 2005 was 367,005 (2004: 325,097) and carrying amount of intangible assets not yet available for use at December 31, 2005 was 1,836,852 (2004: 1,491,137). More details are provided in Note 6.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

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

Correction of errors and reclassifications

In 2005 the Company determined and presented its obligations existing under the defined benefit plans in accordance with IAS 19, “Employee Benefits”. The Company engaged an actuary to perform a valuation of the pension obligations and recorded the defined benefit obligation as of December 31, 2005 and made adjustments to the comparatives as of December 31, 2003 and 2004.

Consolidated balance sheet as at December 31, 2004	As previously reported	Effect of adjustments	As restated	Description of adjustments
Retained earnings	13,199,851	(709,434)	12,490,417	Effect of pension liabilities recognized as of December 31, 2004, (net of tax effect of nil)
Pension Liabilities	-	709,434	709,434	Adjustment for pension liabilities as of December, 31 2004
Consolidated Statement of Operations for 2004				
Wages, salaries, other benefits and payroll taxes	(6,735,501)	(157,014)	(6,892,515)	Net defined benefit pension plan expense for 2004
Consolidated Statement of changes in Equity for the year ended 2003				
Retained Earnings as of December 31, 2003	11,205,113	(552,420)	10,652,693	Effect of pension liabilities recognized as of December 31, 2003 (net of tax effect of nil)

In addition the Company made the following reclassifications to the 2004 financial statements to conform to the 2005 presentation:

Consolidated balance sheet as at December 31, 2004	As previously reported	Effect of reclassifications	As restated	Description of reclassifications
Unrealised gain on investments available-for-sale	-	800	800	Unrealized gain on available-for-sale investments was reclassified from Retained Earnings
Retained earnings	13,199,851	(800)	13,199,051	Unrealized gain on available-for-sale investments was reclassified to line Unrealised gain on investments available-for-sale
Deferred revenue	237,491	95,000	332,491	Deferred revenue reclassification from Other Non-current liabilities
Other non-current liabilities	95,313	(95,313)	-	Deferred revenue reclassification to Deferred revenues in amount 95,000; other reclassifications 313
Accounts payable, accrued expenses and advances received	2,592,453	313	2,592,766	Other reclassifications
Income tax payable	-	114,100	114,100	Reclassification of Income Tax payable from Other Taxes Payable

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

3. Summary of Significant Accounting Policies

3.1 Principles of Consolidation

The consolidated financial statements of the Company represent the financial statements of the Group of companies, i.e. the parent and its subsidiaries, presented as if the Company operated as a single economic entity.

Subsidiaries

Subsidiaries, which are those entities in which the Company has an interest of more than one half of the voting rights, or otherwise has power to exercise control over their operations, are consolidated. The Control is a power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Financials of all subsidiaries are included in the consolidated financial statement. Subsidiaries are consolidated from the date on which control is transferred to the Company and are no longer consolidated from the date that control ceases. All intercompany transactions, balances and unrealized gains on transactions between Company companies are eliminated; unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. In case of necessity, accounting policies for subsidiaries have been changed to ensure consistency with the policies adopted by the Company.

Acquisition of Subsidiaries

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Company. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest.

The excess of purchase consideration over the fair value of the Company’s share of identifiable net assets is recorded as goodwill. If the cost of the acquisition is less than the fair value of the Company’s share of identifiable net assets of the subsidiary acquired the difference is recognized directly in the statement of operations.

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

Losses allocated to minority interest do not exceed the minority interest in the equity of the subsidiary unless there is a binding obligation of the minority to fund the losses. All such losses are allocated to the Company.

Acquisition of Minority Interest in subsidiaries

The difference between the cost of the additional interest in a subsidiary and the minority interest's share of the assets and liabilities is reflected in the consolidated statement of shareholders’ equity at the date of the purchase of the minority interest as a charge to retained earnings. The Company does not remeasure the assets and liabilities of the subsidiary to reflect their fair values at the date of the transaction.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

3. Summary of Significant Accounting Policies (continued)

3.2 Investments in Associates

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

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

3.3 Investments

The Company's investments are classified as either loans and receivables or available-for-sale investments, as appropriate. When investments are recognised initially, they are measured at fair value plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs. The Company determines the classification of its investments upon initial recognition. All purchases and sales of investments are recognised on the settlement date, which is the date that the investment is delivered to or by the Company.

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held-to-maturity when the Company has the positive intention and ability to hold to maturity. During the period the Company did not hold any investments in this category.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than:

- (a) those that the entity intends to sell immediately or in the near term, which shall be classified as held for trading, and those that the entity upon initial recognition designates as at fair value through profit or loss;
- (b) those that the entity upon initial recognition designates as available for sale; or
- (c) those for which the holder may not recover substantially all of its initial investment, other than because of credit deterioration, which shall be classified as available for sale.

Such assets are carried at amortised cost using the effective interest method. Gains and losses are recognised in income when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

3. Summary of Significant Accounting Policies (continued)

3.3 Investments (continued)

Available-for-sale investments are those non-derivative financial assets that are designated as available-for-sale or are not classified in any of the other categories. After initial recognition available-for-sale investments are measured at fair value with gains or losses being recognised as a separate component of equity until the investment is derecognised or until the investment is determined to be impaired, at which time the cumulative gain or loss previously reported in equity is included in the statement of operations. Reversals of impairment losses in respect of equity instruments are not recognised in the statement of operations. Impairment losses in respect of debt instruments are reversed through profit or loss if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss was recognised in the statement of operations.

The fair value of investments that are actively traded in organised financial markets is determined by reference to quoted market bid prices at the close of business on the balance sheet date. For investments where there is no active market, fair value is determined using valuation techniques. Such techniques include using recent arm’s length market transactions; reference to the current market value of another instrument, which is substantially the same; discounted cash flow analysis.

3.4 Changes in Accounting Policies, Accounting Estimates and Errors

Change in accounting policies

The Company changes an accounting policy only if the change is required by a Standard or an Interpretation of IFRS or results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the Company’s financial position, financial performance or cash flows.

The Company accounts for a change in accounting policy resulting from the initial application of a Standard or an Interpretation in accordance with the specific transitional provisions, if any, in that Standard or Interpretation.

Changes in accounting estimates

As a result of the uncertainties inherent in business activities, many items in financial statements cannot be measured with precision but can only be estimated. Estimation involves judgments based on the latest available, reliable information. An estimate may need revision if changes occur in the circumstances on which the estimate was based or as a result of new information or more experience.

When it is difficult to distinguish a change in an accounting policy from a change in an accounting estimate, the change is treated as a change in an accounting estimate. The effect of a change in an accounting estimate is recognized prospectively by including it in profit or loss in the period of the change, if the change affects that period only or the period of the change and future periods, if the change affects both.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

3. Summary of Significant Accounting Policies (continued)

3.4 Accounting Policies, Changes in Accounting Estimates and Errors (continued)

Prior Period Errors

The Company corrects material prior period errors retrospectively in the first set of financial statements authorized for issue after their discovery by restating the comparative amounts for the prior period presented in which the error occurred or if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.

Prior period error is corrected by retrospective restatement except to the extent that it is impracticable to determine either the period-specific effects or the cumulative effect of the error.

3.5 Foreign Currency Transactions

The measurement and presentation currency of the Company is the Russian Rouble, which is the national currency of the Russian Federation. Transactions in foreign currencies are initially recorded in the measurement currency at the rate ruling at the date of transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the measurement currency rate of exchange ruling at the balance sheet date. All resulting differences are taken to the consolidated statement of operations as foreign exchange gains (losses). Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate as at the date of initial transaction.

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

The exchange rates as of December 31, 2005 and 2004 were as follows:

Currency	2005	2004
Russian Roubles per US dollar	28.78	27.75
Russian Roubles per Euro	34.19	37.81
Russian Roubles per Japanese yen	0.25	0.27

3.6. Property, Plant and Equipment

3.6.1 Property, plant and equipment

Property, plant and equipment are recorded at purchase or construction cost, excluding the costs of day-to-day servicing, less accumulated depreciation and accumulated impairment in value. For the property, plant and equipment acquired prior to January 1, 2003, fair values as at January 1, 2003 have been used as deemed cost (refer to Note 2) in accordance with the exemption provided in IFRS 1. The carrying values of that property, plant and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying values 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. Impairment losses are recognized in the statement of operations.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

3. Summary of Significant Accounting Policies (continued)

3.6. Property, Plant and Equipment (continued)

Interest costs on borrowings to finance the construction of property, plant and equipment are capitalized, during the period of time that is required to complete and prepare the asset for its intended use. All other borrowing costs are expensed.

Expenditure for continuing repairs and maintenance are charged to the statement of operations as incurred. Social assets are expensed on acquisition. Major renewals and improvements are capitalized, and the assets replaced are retired.

3.6.2 Depreciation and Useful Life

Depreciation is calculated on property, plant and equipment on a straight-line basis from the time the assets are available for use, over their estimated useful lives as follows:

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

The asset's residual values, useful lives and depreciation methods are reviewed, and adjusted as appropriate, at each financial year-end.

Depreciation of an asset begins when it is available for use, i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Depreciation of an asset ceases at the earlier of the date that the asset is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with IFRS 5 and the date that the asset is derecognised.

The depreciation charge for a period is usually recognized in the statement of operations. However, sometimes, the future economic benefits embodied in an asset are absorbed in producing other assets. In this case, the depreciation charge constitutes part of the cost of the other asset and is included in its carrying amount.

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

3.6.3 Construction in Progress

Construction in progress is recorded as the total of actual expenditures incurred by the Company from the beginning of construction to the reporting date less any impairment in value.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

3. Summary of Significant Accounting Policies (continued)

3.6. Property, Plant and Equipment (continued)

3.6.4 Assets received free of charge

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. A corresponding income is fully recognized in the statement of operations. In the case when transfers of equipment relate to the rendering of future services to the transferee the equipment is considered as deferred revenue which is recognised as income on the same basis that the equipment is depreciated.

Equipment contributions that will not generate any future economic benefit for the Company are not recognized.

3.7 Intangible Assets

3.7.1 Goodwill

Goodwill represents the excess of the cost of an acquisition over the net fair value of the Company’s share of the identifiable assets, liabilities and contingent liabilities of the acquired subsidiary or associate at the date of acquisition. Goodwill on an acquisition of a subsidiary is included in intangible assets. Goodwill on an acquisition of an associate is included in the investments in associates. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is reviewed for impairment, annually or more frequently if events or changes in circumstances indicate that the carrying amount may be impaired. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Company’s cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the Company are assigned to those units or groups of units. Each unit or group of units to which the goodwill is so allocated:

- represents the lowest level within the Company at which the goodwill is monitored for internal management purposes; and
- is not larger than a segment based on either the Company’s primary or the Company’s secondary reporting format determined in accordance with IAS 14 “Segment Reporting”.

Impairment is determined by assessing the recoverable amount of the cash-generating unit (group of cash-generating units), to which the goodwill relates. Where the recoverable amount of the cash-generating unit (group of cash-generating units) is less than the carrying amount, an impairment loss is recognised. Where goodwill forms part of a cash-generating unit (group of cash-generating units) and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained.

An impairment loss recognized for goodwill is not reversed in a subsequent period.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

3. Summary of Significant Accounting Policies (continued)

3.7 Intangible Assets (continued)

3.7.2 Licenses

Cost of licenses paid to Government for permission to provide telecommunication services within identifiable period of time is recognized as intangible assets. The Company recognizes cost of GSM licenses at fair value as at transition to IFRS date.

3.7.3 Software and Other Intangible Assets

Software and other intangible assets acquired separately are measured on initial recognition at cost. The cost of other intangible assets acquired in a business combination is their fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses.

3.7.4 Useful Life and Amortization of Intangible Assets

The Company assesses whether the useful life of an intangible asset is finite or indefinite and, if finite, the length of, or number of production or similar units constituting, that useful life. An intangible asset is regarded by the entity as having an indefinite useful life when, based on an analysis of all of the relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity.

Intangible assets with finite lives are amortized over the useful economic lives and assessed for impairment whenever there is an indication that the intangible asset may be impaired.

Amortization periods and methods for intangible assets with finite useful lives are reviewed at least at each financial year-end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset is accounted for by changing the amortization period or method, as appropriate, and treated as changes in accounting estimates.

The cost of licenses and software is depreciated on a straight-line basis over the estimated useful life equal to the term of the licenses or the right to use the software. Useful life of other intangible assets is approximately 10 years.

Intangible assets with indefinite useful lives are not amortized, but tested for impairment annually either individually or at the cash-generating unit level. The useful life of an intangible asset with an indefinite life is reviewed annually to determine whether indefinite life assessment continues to be supportable. If not, the change in the useful life assessment from indefinite to finite is made on a prospective basis.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

3. Summary of Significant Accounting Policies (continued)

3.8 Borrowing Costs

The borrowing costs are capitalized by the Company as part of the cost of the asset when it is probable that they will result in future economic benefits to the entity and the costs are directly attributable to the acquisition, construction or production of a qualifying asset including construction in progress.

To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization on that asset is determined as the actual borrowing costs incurred on that borrowing during the period.

To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization is determined by applying a capitalization rate to the expenditures on that asset. The capitalization rate is the weighted average of the borrowing costs applicable to the borrowings of the entity that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. The amount of borrowing costs capitalized during a period shall not exceed the amount of borrowing costs incurred during that period.

3.9 Leases

Leases where all the risks and rewards of ownership of the asset are transferred from lessor to lessee are classified as finance leases.

Leases where the lessor retains substantially all the risks and rewards of ownership of the asset are classified as operating leases.

3.9.1 Finance Leases

At the commencement of the lease term, or the date from which the lessee is entitled to exercise its right to use the leased asset, the Company recognizes finance leases as assets and liabilities in their balance sheets at amounts equal to the fair value of the leased property or, if lower, the present value of the minimum lease payments, each determined at the inception of the lease. At the commencement of the lease term, the asset and the liability for the future lease payments are recognized in the balance sheet at the same amounts except for any initial direct costs of the lessee that are added to the amount recognized as an asset.

Minimum lease payments are apportioned between the finance charge and the reduction of the outstanding liability. The finance charge is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

The depreciation policy for depreciable leased assets is consistent with that for depreciable assets that are owned, and the depreciation recognized is calculated in accordance with the accounting policy of the Company applicable for depreciable and amortized assets. If there is no reasonable certainty that the Company will obtain ownership by the end of the lease term, the asset is fully depreciated over the shorter of the lease term and its useful life.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

3. Summary of Significant Accounting Policies (continued)

3.9 Leases (continued)

3.9.2 Operating Leases

Operating lease payments are recognised as an expense in the statement of operations on a straight-line basis over the lease term.

3.10 Inventories

Inventories are recorded at the lower of cost and net realizable value. Cost of inventory is determined on the weighted average basis. Net realizable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and the estimated costs necessary to make the sale.

The cost of inventories comprises all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

3.11 Advances Given

Advances given to acquire non-current assets are classified as non-current and considered non-monetary asset. Long-term advances given for operating activities are also classified as non-current asset.

3.12 Financial Instruments

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

Financial assets comprise cash and cash equivalents; an equity instrument of another entity; a contractual right to receive cash or another financial asset from another entity, or to exchange financial assets or financial liabilities with another entity under conditions that are potentially favorable to the Company; or a contract that will or may be settled in the Company’s own equity instruments and is a non-derivative for which the Company is or may be obliged to receive a variable number of the Company’s own equity instruments, or a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the Company’s own equity instruments. For this purpose the Company’s own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the Company’s own equity instruments.

Financial liabilities include contractual obligations to deliver cash or another financial asset to another entity or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the Company; or a contract that will or may be settled in the Company’s own equity instruments and is a non-derivative for which the Company is or may be obliged to deliver a variable number of the Company’s own equity instruments or a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the Company’s own equity instruments. For this purpose the Company’s own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity’s own equity instruments.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

3. Summary of Significant Accounting Policies (continued)

3.12 Financial Instruments (continued)

The Company recognizes a financial asset or a financial liability on its balance sheet when, and only when, the Company becomes a party to the contractual provisions of the instrument.

When a financial asset or financial liability is recognized initially, the Company measures it at its fair value plus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.

The Company classifies its financial assets and financial liabilities as current or non-current based on term of its maturity taking into account other factors that limit the Company’s ability to realize assets within 12 months or existence of call options in financial liabilities valid within 12 months after the balance sheet date.

Financial asset is derecognised when the rights to receive cash flows from the asset expired or the Company transferred its rights to receive cash flows from the asset.

Financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

3.13 Cash and Cash Equivalents

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

3.14 Accounts Receivable and Provision for Bad Debt

Trade receivables, are recognized at original invoice amount less an allowance for any uncollectible amounts. Allowance is made when there is objective evidence that the Company will not be able to collect the debts.

Provision for impairment of receivables is created based on the historical pattern of collections of accounts receivable and specific analysis of recoverability of significant accounts.

Provision for impairment is also created for other accounts receivable except advances given based on the assessment of the Company’s ability to collect the debts.

Provision for impairment is recognized in the statement of operations.

The carrying amount of current trade receivables is a reasonable approximation of their fair value.

The fair value of non-current trade receivable is calculated using the effective interest method.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

3. Summary of Significant Accounting Policies (continued)

3.15 Non-current Assets Held for Sale and Discontinued Operations

A discontinued operation is a component of the Company that either has been disposed of, or is classified as held for sale, and represents a separate major line of business or geographical area of operations, is part of a single co-coordinated plan to dispose of a separate major line of business or geographical area of operations or is a subsidiary acquired exclusively with a view to resale.

The Company classifies a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use.

The Company measures a non-current asset (or disposal group) classified as held for sale at the lower of its carrying amount and fair value less costs to sell.

Immediately before the initial classification of the asset (or disposal group) as held for sale, the carrying amounts of the asset (or all the assets and liabilities in the group) are measured in accordance with applicable IFRSs.

The Company presents and discloses information that enables users of the financial statements to evaluate the financial effects of discontinued operations and disposals of non-current assets (or disposal groups).

3.16 Troubled Debt Restructurings

A troubled debt restructuring occurs when the Company grants a concession to the debtor in the forms of modification of the terms of the debt, including the extension of the maturity date, change of payment schedule or reduction of the face amount of the debt, or in the form of transfer of the assets or an equity interest in the debtor in satisfaction of the debt. The Company recognized a loss in the amount of the difference between the fair value of the assets and/or equity interest received and the recorded amount of the receivable. This loss will be recognized in full in the period the restructuring takes place.

3.17 Loans Given

Loans given are recognized at the amortized cost, using the effective interest method less provision for impairment or uncollectibility. Loans given are recorded as the non-current assets unless the repayment is expected within 12 months after the balance sheet date.

3.18 Loans and Borrowings Received

Loans and Borrowings are initially recognised at the fair value of the consideration received less directly attributable transaction costs. After initial recognition, borrowings are measured at amortised cost using the effective interest method; any difference between the fair value of the consideration received (net of transaction costs) and the redemption amount is recognised as an adjustment to interest expense over the period of the borrowings.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

3. Summary of Significant Accounting Policies (continued)

3.19 Employee Benefits

3.19.1 Unified social tax

Under provisions of the Russian legislation, social contributions are made through a unified social tax (“UST”) calculated by the Company by the application of a regressive rate (from 26% to 17%) 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 20% 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.

3.19.2 Current employment benefits

Wages and salaries paid to employees are recognized as expense in current period.

3.19.3 Other pension plans and post-employment benefits

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

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

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

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

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

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

3. Summary of Significant Accounting Policies (continued)

3.20 Income Taxes

Tax expense (tax income) is the aggregate amount included in the determination of profit or loss for the period in respect of current tax and deferred tax.

Current tax is the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period determined in accordance with the rules established by the taxation authorities, upon which income taxes are payable (recoverable).

Current tax liabilities (assets) for the current and prior periods are measured at the amount expected to be paid to (recovered from) the taxation authorities, using the tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date.

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

The measurement of deferred tax liabilities and deferred tax assets reflects the tax consequences that would follow from the manner in which the entity expects, at the balance sheet date, to recover or settle the carrying amount of its assets and liabilities.

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

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

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. Any such previously recognized reduction is reversed to the extent that it becomes probable that sufficient taxable profit will be available.

Deferred tax assets and liabilities are not discounted.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

3. Summary of Significant Accounting Policies (continued)

3.21 Shareholders' Equity

3.21.1 Share capital

Ordinary shares and non-redeemable preference shares with discretionary dividends are both classified as equity.

3.21.2 Dividends

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

3.22 Minority Interest

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

3.23 Revenue Recognition

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

Revenue is recognized in the amount of cash or cash equivalents received in the form of cash or receivable. However, when the inflow of cash or cash equivalents is deferred, the fair value of the consideration may be less than the nominal amount of cash received or receivable. When the arrangement effectively constitutes a financing transaction, the fair value of the consideration is determined by discounting all future receipts using an effective interest rate.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

3. Summary of Significant Accounting Policies (continued)

3.23 Revenue Recognition (continued)

3.23.1 Revenue from customers

The Company categorizes the revenue sources in fourteen major categories:

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

Long distance calls (domestic and international)

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

Local telephone calls

Revenue from the local telephone services depends on the duration of the telephone connections and subscription fee, while time driven billing scheme is applied. If fixed payment scheme is applied then revenue depends on the subscription fee only. Customers of the Company use the service via installed fixed telephone, as well the service could be accessed by means of pay-phone. The Company recognizes revenues related to the monthly network fees for local services in the month the service is provided to the subscriber.

Installation and connection fees

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

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

3. Summary of Significant Accounting Policies (continued)

3.23 Revenue Recognition (continued)

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.

Cellular services

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

Radio and TV broadcasting

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

Data transfer and telematics services

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

New services

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

Rent of telephone channels

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

Services for national operators

Revenue from national service providers includes two different groups.

The first group of revenues represents services rendered to the Company’s partners for termination of long-distance traffic of its operators-partners in the network of the Company.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

3. Summary of Significant Accounting Policies (continued)

3.23 Revenue Recognition (continued)

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

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

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

Services for international operators

The revenues represents services rendered to interconnected international telecom operators that transfer international traffic of their customers via network of the Company.

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

Other telecommunication services

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

Other revenues

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

3.24 Barter Transactions

When goods or services are exchanged for goods or services which are of a similar nature and value, the exchange is not regarded as a transaction which generates revenue. When goods are sold or services are rendered in exchange for dissimilar goods or services, the exchange is regarded as a transaction which generates revenue. The revenue is measured at the fair value of the goods or services received, adjusted by the amount of any cash or cash equivalents transferred. When the fair value of the goods or services received cannot be measured reliably, the revenue is measured at the fair value of the goods or services given up, adjusted by the amount of any cash or cash equivalents transferred.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

3. Summary of Significant Accounting Policies (continued)

3.25 Earnings per Share

The Company calculates basic earnings per share amounts for profit or loss attributable to equity holders of the parent entity and, if presented, profit or loss from continuing operations attributable to those equity holders. Basic earnings per share are calculated by dividing profit or loss attributable to equity holders of the parent entity (the numerator) by the weighted average number of shares outstanding (the denominator) during the period.

The Company’s preference shares are considered participating equity instruments for the purpose of earnings per share calculations (see Note 28).

3.26 Provisions

Provisions are recognized when the Company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made. Where the Company expects a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain.

If the effect of 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 a borrowing cost.

3.27 Contractual Commitments

Contractual commitments comprise legally binding trading or purchase agreements with stated amount, price and date or dates in the future.

The Company discloses significant contractual commitments in the Notes to the financial statements.

The asset or liability under contractual commitments are not recognized in the financial statement until any of the parties performs in accordance with the contract and until any of the party became legally liable to pay or entitled to receive the payment under the terms of the contract.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

3. Summary of Significant Accounting Policies (continued)

3.28 Contingent Assets and Contingent Liabilities

A contingent liability is a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Company or a present obligation that arises from past events but is not recognized because it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation or the amount of the obligation cannot be measured with sufficient reliability. The Company does not recognize a contingent liability. A contingent liability is disclosed unless the possibility of an outflow of resources embodying economic benefits is remote.

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Company. The Company does not recognize a contingent asset. A contingent asset is disclosed where an inflow of economic benefits is probable.

3.29 Segment Information

The Company provides fixed line and mobile telecommunication services. Management believes that the Company operates in one geographical segment on the territory of Povolzhie region of the Russian Federation.

3.30 Related Party Transactions

The Company defines the following terms to specify the related party: a party is related to the Company if:

1. directly, or indirectly through one or more intermediaries, the party controls, is controlled by, or is under common control with, the Company (this includes parents, subsidiaries and fellow subsidiaries), has an interest in the entity that gives it significant influence over the entity or has joint control over the entity;
2. the party is an associate (as defined in IAS 28 Investments in Associates) of the entity;
3. the party is a joint venture in which the entity is a venturer (see IAS 31 Interests in Joint Ventures);
4. the party is a member of the key management personnel of the entity or its parent;
5. the party is a close member of the family of any individual referred to in (1) or (4);
6. the party is an entity that is controlled, jointly controlled or significantly influenced by, or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in 4 or 5; or
7. the party is a post-employment benefit plan for the benefit of employees of the entity, or of any entity that is a related party of the entity.

Relationships between the parent and its subsidiaries and between subsidiaries themselves are not disclosed by the Company.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

3. Summary of Significant Accounting Policies (continued)

3.31 Events After the Balance Sheet Date

The Company adjusts the amounts recognized in its financial statements to reflect adjusting events after the balance sheet date. Events that require an entity to adjust the amounts recognized in its financial statements are caused by favorable and unfavorable outcomes of conditions that existed at the balance sheet date and changes in management estimates subject to uncertainties which was used for accounting of a number of business activities.

If non-adjusting events after the balance sheet date are material, their nondisclosure could influence the economic decisions of users taken on the basis of the financial statements. Accordingly, the Company discloses the nature of the event and an estimate of its financial effect, or a statement that such an estimate cannot be made the following for each material category of non-adjusting event after the balance sheet date.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

4. Segment Information

	Fixed line	Mobile	2005 Intercompany eliminations	Total for the Company
REVENUE				
Sales to third parties	20,944,518	2,811,715		23,756,233
Inter-segment sales	327,611	252,380	(579,991)	-
Total revenue	21,272,129	3,064,095	(579,991)	23,756,233
Segment result	3,863,545	856,724	-	4,720,269
Unallocated corporate expenses	-	-	-	-
Operating profit				4,720,269
Share of result of associates	20,713	-	-	20,713
Interest expense, net	(773,877)	(69,655)	-	(843,532)
Gain on sale of subsidiaries, associates and other investments				41,842
Foreign exchange gain, net	31,907	21,211	-	53,118
Income tax	(1,210,833)	(180,788)	-	(1,391,621)
Net profit				2,600,789
Assets and Liabilities				
Segment assets	31,945,120	5,009,427	(105,005)	36,849,542
Investments in associates	119,980	-	-	119,980
Consolidated total assets				36,969,522
Segment liabilities	(16,280,436)	(2,015,528)	105,005	(18,190,959)
Consolidated total liabilities				(18,190,959)
OTHER INFORMATION				
Capital expenditure	5,234,475	1,160,121		6,394,596
Depreciation and amortization	2,998,684	418,975		3,417,659
Other non-cash expenses (provision for impairment of receivables)	(2,170)	14,190		12,020
Obsolescence of inventory	2,874	-		2,874

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

4. Segment Information (continued)

	2004			
	Fixed line	Mobile	Intercompany eliminations	Total for the Company
REVENUE				
Sales to third parties	18,278,097	2,688,446		20,966,543
Inter-segment sales	350,122	48,231	(398,353)	-
Total revenue	18,628,219	2,736,677	(398,353)	20,966,543
Segment result	3,310,949	768,910	-	4,079,859
Unallocated corporate expenses				-
Operating profit				4,079,859
Share of result of associates	72,549	-	-	72,549
Interest expense, net	(579,662)	(64,296)	-	(643,958)
Gain on sale of subsidiaries, associates and other investments				88,144
Foreign exchange gain, net	(17,029)	2,738	-	(14,291)
Income tax	(999,316)	(167,941)	-	(1,167,257)
Net profit				2,415,046
Assets and Liabilities				
Segment assets	29,656,339	2,584,353	(69,826)	32,170,866
Investments in associates	110,096	-	-	110,096
Consolidated total assets				32,280,962
Segment liabilities	(13,984,872)	(1,644,596)	69,826	(15,559,642)
Consolidated total liabilities				(15,559,642)
OTHER INFORMATION				
Capital expenditure	6,938,434	1,054,559		7,992,993
Depreciation and amortization	2,279,741	304,934		2,584,675
Other non-cash expenses (provision for impairment of receivables)	583,118	16,535		599,653

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

Unallocated expenses, assets and liabilities are expenses, assets and liabilities that arise at the entity level and relate to the entity as a whole.

Segment assets consist primarily of property, plant and equipment, intangible assets, inventories, receivables, and operating cash and exclude assets that relate to the Company as a whole. Segment liabilities primarily comprise operating liabilities, loans and leasing liabilities and exclude items pertaining to the Company as a whole.

Capital expenditure comprises additions to property, plant and equipment. Provisions relate only to those charges made against allocated assets.

Segments are comprised of separate legal entities who file separate tax returns. Accordingly, income tax expense was allocated to the segments in full.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

5. Property, Plant and Equipment

	Land, buildings and constructions	Switches and transmission devices	Construction in progress and equipment for installation	Vehicles and other	Total
Cost					
At December 31, 2003	9,397,798	9,317,555	1,338,461	2,443,002	22,496,816
Additions	-	-	7,992,993	-	7,992,993
Additions due to acquisition of subsidiaries	-	7,481	-	-	7,481
Disposals	(95,410)	(75,126)	(10,296)	(61,804)	(242,636)
Disposals due to sale of subsidiaries	(72,800)	(96,262)	(40,322)	(10,059)	(219,443)
Transfers	3,038,062	3,439,274	(7,551,922)	1,074,586	-
At December 31, 2004	12,267,650	12,592,922	1,728,914	3,445,725	30,035,211
Additions	-	-	6,394,596	-	6,394,596
Additions due to acquisition of subsidiaries	-	55,208	11,703	-	66,911
Disposals	(89,997)	(87,605)	(61,738)	(21,295)	(260,635)
Disposals due to sale of subsidiaries	-	(997)	-	-	(997)
Transfers	2,257,164	3,332,994	(6,649,081)	1,058,923	-
At December 31, 2005	14,434,817	15,892,522	1,424,394	4,483,353	36,235,086
Accumulated Depreciation					
At December 31, 2003	(470,480)	(1,124,166)	-	(390,531)	(1,985,177)
Charge for the year	(551,538)	(1,444,350)	-	(526,022)	(2,521,910)
Charge due to acquisition of subsidiaries	-	-	-	-	-
Disposals	7,751	29,263	-	11,982	48,996
Disposals due to sale of subsidiaries	5,144	14,803	-	6,439	26,386
At December 31, 2004	(1,009,123)	(2,524,450)	-	(898,132)	(4,431,705)
Charge for the year	(747,223)	(1,840,913)	-	(729,854)	(3,317,990)
Charge due to acquisition of subsidiaries	-	-	-	-	-
Disposals	14,027	20,126	-	5,573	39,726
Disposals due to sale of subsidiaries	-	493	-	-	493
At December 31, 2005	(1,742,319)	(4,344,744)	-	(1,622,413)	(7,709,476)
Net book value as of December 31, 2003	8,927,318	8,193,389	1,338,461	2,052,471	20,511,639
Net book value as of December 31, 2004	11,258,527	10,068,472	1,728,914	2,547,593	25,603,506
Net book value as of December 31, 2005	12,692,498	11,547,778	1,424,394	2,860,940	28,525,610

The net book value of plant and equipment held under finance leases at December 31, 2005 and 2004 amounted to:

	2005	2004
Switches and transmission devices	1,592,034	1,614,447
Vehicles and other	60,114	41,457
Construction in progress and equipment for installation	31,935	4,683
Buildings and constructions	13,660	14,463
Total net book value of plant and equipment held under finance leases	1,697,743	1,675,050

Leased assets are pledged as security for the related finance lease obligations (see Note 19).

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

5. Property, Plant and Equipment (continued)

The net book value of property, plant and equipment, which were received on vendor financing terms, amounted as of December 31, 2005 to 1,383,052 (2004 – 1,503,318).

In 2005, the Company increased construction in progress by the amount of capitalized interest totaling 167,935 (2004 – 183,613). Capitalization rate in 2005 was 15% (2004 - 12%).

Bank borrowings are secured by properties with the carrying value as of December, 31 2005 of approximately 8,182,160 (2004 – 8,918,000) (see Note 18).

The Company did not own property plant, plant and equipment which were subject to joint ownership as of December 31, 2005 (2004 – 81,256).

6. Intangible Assets and Goodwill

	Goodwill	Licenses	Software	Other	Total
Cost					
At December 31, 2003	323,811	167,055	763,312	99,339	1,353,517
Additions	-	14,325	901,833	306	916,464
Additions due to acquisition of subsidiaries	1,286	-	19	-	1,305
Disposals	-	-	(2,557)	(120)	(2,677)
Disposals due to sale of subsidiaries	-	-	(202)	-	(202)
At December 31, 2004	325,097	181,380	1,662,405	99,525	2,268,407
Additions	-	4,340	631,724	463	636,527
Additions due to acquisition of subsidiaries	41,908	-	171	-	42,079
Disposals	-	(10)	(633)	(90)	(733)
Disposals due to sale of subsidiaries	-	-	(1)	-	(1)
At December 31, 2005	367,005	185,710	2,293,666	99,898	2,946,279
Accumulated amortization					
At December 31, 2003	-	(13,937)	(16,072)	(10,685)	(40,694)
Charge for the year	-	(17,490)	(32,294)	(12,981)	(62,765)
Charge due to acquisition of subsidiaries	-	-	-	-	-
Disposals	-	-	2,495	12	2,507
Disposals due to sale of subsidiaries	-	-	13	-	13
At December 31, 2004	-	(31,427)	(45,858)	(23,654)	(100,939)
Charge for the year	-	(17,545)	(74,006)	(8,118)	(99,669)
Charge due to acquisition of subsidiaries	-	-	(140)	-	(140)
Disposals	-	-	84	-	84
At December 31, 2005	-	(48,972)	(119,920)	(31,772)	(200,664)
Net book value at December 31, 2003	323,811	153,118	747,240	88,654	1,312,823
Net book value at December 31, 2004	325,097	149,953	1,616,547	75,871	2,167,468
Net book value at December 31, 2005	367,005	136,738	2,173,746	68,126	2,745,615

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

6. Intangible Assets and Goodwill (continued)

Oracle E-Business Suite (OEBS)

As of December 31, 2005 software includes OEBS software with a gross book value of 1,121,410 (2004 – 845,558), including interest capitalized of 211,813 (2004 – 76,934). Capitalization rate in 2005 was 15% (2004 - 12%). In accordance with the supply contract, the Company acquired non-exclusive licenses for 13,029 users of E-business Suite 2003 Professional among other license applications.

The Company commenced the commercial operation of OEBS in relation to the module for accounting for non-current assets, the Release #1, in line with the pilot stage of the completion of the installation in Kirov and Head Office branches on December 30, 2005.

Full implementation of Oracle E-Business Suite software is expected to be completed by 2008.

The Company will commence amortizing the value of the mentioned software from the date of its implementation, proportionally to the quantity of licenses used, over the useful life of the licenses of 10 years.

Amdocs Billing Suite

As of December 31, 2005 software also includes Amdocs Billing Suite software with a gross book value of 715,442 (2004 – 645,579), including the discount from promissory notes capitalized totaling 31,088 (2004 – nil). The capitalization rate in 2005 was 6%. This software was purchased for the purpose of the implementation of unified automated settlements system. The project of implementation of the unified automated settlements system is expected to last 4-5 years.

Amdocs Billing Suite software was supplied in December 2004 by LLC IBM Eastern Europe/Asia, in exchange for zero coupon 18 promissory notes for the total amount of 755,662. Repayment of promissory notes issued is expected to be exercised by June 1, 2006.

The Company will commence amortizing this asset from the date of software implementation.

Licenses

As of December 31, 2005 licenses mainly included GSM 900 licenses with the net book value of 136,738 (2004 – 149,953). The Company measured GSM licenses at the date of transition to IFRS at fair value and used that fair value as deemed cost at that date. The remaining useful lives of licenses are approximately 7 years.

Amortization charge for 2005 in the amount of 99,669 (2004 – 62,765) was recorded in line Depreciation and Amortization of Consolidated Statement of Operations.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

6. Intangible Assets and Goodwill (continued)

Impairment testing of goodwill

Goodwill acquired through business combinations has been allocated to the following cash-generating units for impairment testing:

- OJSC “Tatincom-T”
- CJSC “RTCOM”
- LLC “Nizhegorodsky teleservice”
- Other subsidiaries

The recoverable amounts of OJSC “Tatincom”, CJSC “RTCOM” and LLC “Nizhegorodsky teleservice”, other subsidiaries cash-generating units have been determined based on a value in use calculation using cash flow projections based on financial budgets approved by senior management covering a five-year period. Cash flows beyond the five-year period are extrapolated using a 0.5% growth rate (2004: 0.5%) that is the same as the long-term average growth rate for the above mentioned cash-generating units. The discount rate applied to cash flow projections is 16% (2004: 16%).

The following describes each key assumption applied by the management for cash flow projections to undertake impairment testing of goodwill:

- Budgeted gross margins – the basis used to determine the value assigned to the budgeted gross margins is the average gross margins achieved in the year immediately before the budgeted year, increased for expected efficiency improvements;
- Bond rate – the yield on five-year Russian government Rouble-denominated bonds at the beginning of the budgeted year.

Carrying amount of goodwill allocated to each of the cash-generating units:

Subsidiary	Carrying amount of goodwill	
	2005	2004
OJSC “Tatincom”	323,811	323,811
CJSC “RTCOM”	33,075	-
LLC “Nizhegorodsky teleservice”	8,833	-
Other subsidiaries	1,286	1,286
Total	367,005	325,097

As of December 31, 2005 no impairment was identified by the Company after the testing of OJSC “Tatincom”, CJSC “RTCOM” and LLC “Nizhegorodsky teleservice” and other subsidiaries for impairment.

Impairment test of intangible assets not yet available for use

The Company performed impairment tests of intangible assets not yet available for use. These assets represent cost of Oracle E-Business Suite and Amdocs Billing Suite totaling 1,836,852 at December 31, 2005 (as at December 31, 2004 – 1,491,137). As at December 31, 2005 no impairment was identified.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

7. Consolidated Subsidiaries

The consolidated financial statements include the assets, liabilities and financial results of OJSC “VolgaTelecom” and its subsidiaries, whose main activity is provision of cellular and other telecommunication services. The subsidiaries are listed below:

Subsidiary	Main Activity	Ownership,%		Voting Shares	
		2005	2004	2005	2004
CJSC “Nizhegorodskaya Sotovaya svyaz” (NCC)	Cellular services (GSM-900)	100	100	100	100
CJSC “Tsifrovye Telecommunicatsii”	Local telephone network services	100	100	100	100
CJSC “Telesvyazinform”	Cable and air TV services	100	100	100	100
LLC Russian-American SP “Izhcom”	Data transmission and telematics services	100	100	-	-
LLC “Vyatka-Page”	Paging services	91	91	-	-
CJSC “Transsvyaz”	Local telephone network services	80	80	80	80
OJSC “Omrix”	Local telephone network services	74	74	74	74
CJSC “Ulianovsk –GSM”	Cellular services (GSM-900)	60	60	60	60
CJSC “Orenburg GSM”	Cellular services (GSM-900)	51	51	51	51
OJSC “Tatincom-T”	Cellular services (GSM-900)	50+1 share	50+1 share	50+1 share	50+1 share
CJSC “Narodny Telephone Saratov”	Cellular services (CDMA)	50+1 share	50+1 share	50+1 share	50+1 share
CJSC “Nizhegorodsky radiotelephone”	Local telephone network services	50	50	50	50
CJSC “Chery - Page”	Paging services	50	50	50	50
CJSC “RTCOM”	Cellular services	100	-	100	-
LLC “Nizhegorodsky teleservice”	Local telephone services	100	-	-	-
CJSC “Puls Radio Ioshkar-Ola”	Radio services	-	61	-	61
CJSC “Sotovaya svyaz Mordovii”	Cellular services (GSM-900)	-	60	-	60
LLC “RadioResonans”	Radio services	-	51	-	-

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

On March 9, 2005 in accordance with the decision of the Board of Directors dated December 22, 2004 the Company acquired a 100% stake in CJSC “RTCOM” (8,248 ordinary shares) for 10,130. The subsidiary was purchased for the purpose of rendering cellular services in the Mordovia region as part of the Company’s mobile business development program. Management believes that the fair value of CJSC “RTKOM” identifiable assets, liabilities and contingent liabilities as at the acquisition date approximated their book value.

In July 2005 the Company acquired a 100% stake in LLC “Nizhegorodsky teleservice” from LLC “Invekt” for 43,728. The subsidiary was purchased for the purpose of expansion of data transfer and telematic services rendered by the Company. Management believes that the fair value of LLC “Nizhegorodsky teleservice” identifiable assets, liabilities and contingent liabilities as at acquisition date approximated their book value.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

7. Consolidated Subsidiaries (continued)

Management assigned the acquisition price for the 100% stake in CJSC “RTCOM” and 100% stake in LLC “Nizhegorodsky teleservice” as follows:

	CJSC "RTCOM"	LLC "Nizhegorodsky teleservice"	Total
Acquisition price	10,130	43,728	53,858
Transaction costs	-	-	-
Total paid	10,130	43,728	53,858
Assigned value of identifiable assets and liabilities:			
Property, plant and equipment, net	14,524	27,606	42,130
Intangible assets, net	-	38	38
Other Non-current Assets	925	608	1,533
Accounts receivable	4,002	4,455	8,457
Cash and cash equivalents	157	2,715	2,872
Other current assets	3,673	1,097	4,770
Current liabilities	(7,233)	(1,624)	(8,857)
Long-term liabilities	(38,993)	-	(38,993)
Total net assets	(22,945)	34,895	11,950
Company's share in acquired net assets	100%	100%	
Assigned value of acquired share in identifiable net assets	(22,945)	34,895	11,950
Amount of goodwill at December 31, 2005, net	33,075	8,833	41,908

Goodwill is mainly attributable to economic potential of the market assuming low regional penetration level as of the date of acquisition.

Profit (loss) of CJSC “RTCOM” and LLC “Nizhegorodsky teleservice” for 2005 year from the date of acquisition was (13,409) and 1,793 correspondingly. If the combination had taken place at the beginning of the year, the profit of the Company would have been 2,598,945 and revenue would have been 23,781,340.

Disposal of shares in subsidiaries for 2005 is presented below:

Name	Main activity	Carrying amount of net assets disposed	Proceeds from sale	Sale/disposal of share in equity on the date of transaction, %
CJSC “Puls Radio Ioshkar-Iola”	Radio services	601	1,682	61
CJSC “Sotovaya svyaz Mordovii”	Cellular services (GSM-900)	(3,906)	899	60
LLC “RadioResonans”	Radio services	14	807	51
Total			3,388	

Profit / loss on sale of shares in subsidiaries is presented in Note 26.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

8. Investments in Associates

Investments in associates at December 31, 2005 and 2004 comprised the following:

Associate	Activity	2005		2004	
		Voting shares	Carrying value	Voting shares	Carrying value
CJSC “Samara Telecom”	Local telephone network services	28%	96,925	28%	77,695
OJSC “Telesot”	Local telephone network services	-	-	32%	10,248
ACB “S-Bank”	Banking services	42%	19,178	42%	16,596
Other	Cellular services	40%	3,877	40%-49%	5,557
Total			119,980		110,096

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

The Company has investments in the following associates whose net assets were negative as of December 31, 2005 and 2004:

Name	Activity	Voting share, %	Net assets as of December 31	
			2005	2004
CJSC “Saratov-Mobile”	Cellular services (AMPS)	50%	(93,815)	(75,537)
CJSC “Chuvashiya Mobile”	Cellular services (AMPS)	30%	(19,054)	(2,251)

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 the associated company, except for investments in CJSC “Saratov-Mobile”, and CJSC “Chuvashiya Mobile”. For these latter associates the carrying amounts of the investments were reduced to zero considering that such associates reported accumulated losses exceeding the cost of the respective investments.

Disposal of shares in associates for 2005 is presented below:

Associate	Main activity	Carrying value of investment in associate	Sale/disposal of share in equity on the date of transaction, %	Proceeds from sale
OJSC “Telesot”	Local telephone network services	10,829	32%	17,680
CJSC “Puls Radio”	Radio services	-	40%	280
Total		10,829		17,960

Gain/(loss) from sale of shares in associates is presented in Note 26.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

8. Investments in Associates (continued)

Movement in investments in associates for the years ended December 31, 2005 and 2004 is presented below:

	2005	2004
Investments in associates at January 1	110,096	219,080
Share of income net of income tax, and of dividends received	20,713	72,549
Reclassifications of financial investments	-	(3,239)
Sale of associates	(10,829)	(178,294)
Investments in associates at December 31	119,980	110,096

Share of results of associates is presented net of income tax of 1,526.

The following table illustrates summarised financial information of the associates:

Associate	Voting shares	Assets	Liabilities	Revenues	Net income/(loss)
2005					
CJSC “Samara Telecom”	28%	404,853	(56,201)	254,413	69,176
CJSC “Saratov-Mobile”	50%	144,787	(238,602)	121,642	(18,457)
ACB “S-Bank”	42%	199,003	(153,046)	9,945	6,187
CJSC “Chuvashiya Mobile”	30%	90,402	(109,456)	37,133	(16,803)
2004					
CJSC “Samara Telecom”	28%	348,348	(68,870)	222,468	48,825
CJSC “Saratov-Mobile”	50%	140,376	(215,913)	74,800	(24,449)
ACB “S-Bank”	42%	159,630	(119,860)	15,177	(833)
CJSC “Chuvashiya Mobile”	30%	85,746	(87,997)	17,857	51,594
OJSC “Telesot”	32%	40,730	(9,101)	28,977	6,035

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

9. Long-term investments, net

As of December 31, 2005 and 2004, the Company’s investments comprised the following:

Company	2005		2004	
	Ownership interest	Carrying value	Ownership interest	Carrying value
OJSC “Informatsionnye Tehnologii Svyazy” (OJSC “Svyazintech”)	13%	14,880	-	-
CJSC “RusleasingSvyaz”	7.3%	12,293	7.3%	12,293
OJSC “AlfaBank” promissory notes	-	2,583	-	2,583
OJSC “Svyaz-bank”	0.05%	3,987	0.05%	3,987
OJSC “Sberbank RF”	0.0003%	2,137	0.0003%	803
CJSC “TeleRoss-Samara”	10.0%	990	10.0%	990
CJSC “Reg-time”	17.0%	570	17.0%	570
OJSC “Promstroybank”	-	-	0.7%	7,496
LLC “Raduga-poisk”	-	-	10.0%	3,079
OJSC “Ayar”	-	-	0.23%	443
“Union-Card”	-	-	15.0%	402
Other		2,291		1,803
Impairment provision		(14,821)		(23,197)
Total investment available-for-sale, net		24,910		11,252

Management believes that the carrying amount of these investments approximates their fair values.

Purchase of share in OJSC “Informatsionnye Tehnologii Svyazy” (OJSC “Svyazintech”)

In accordance with the resolution of the extraordinary meeting of the Company’s shareholders held on 14 February 2005 the Company acquired 13% of shares in OJSC “Svyazintech” for 19.5. In August 2005 the Company purchased additional newly issued 1,486,082 ordinary shares of OJSC “Svyazintech” for 14,861 in order to maintain its 13% share.

OJSC “Svyazintech” was established in 2005 for the implementation of Amdocs billing software in the companies of OJSC “Svyazinvest” Group (the parent company).

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

10. Long-term accounts receivable and other assets

As of December 31, 2005 and 2004 long-term accounts receivable and other assets comprised the following:

	2005	2004
Long-term accounts receivable	5,083	3,308
Long-term loans given to employees	15,752	18,283
Total	20,835	21,591

As of December 31, 2005 and 2004 long-term loans given to employees are accounted at amortized cost using the effective interest rate of 18% .

11. Long-Term Advances Given

As of December 31, 2005 and 2004 long-term advances given to suppliers of equipment comprised the following:

	2005	2004
Advances given for capital construction	483,900	183,505
Acquisition and implementation of Oracle E-Business Suite software (Note 6)	124,429	44,293
Implementation of Amdocs Billing Suite software (Note 6)	140,726	-
Total	749,055	227,798

12. Inventories

Inventories at December 31, 2005 and 2004 comprised the following:

	2005	2004
Cable, materials and spare parts for telecommunications equipment	194,382	361,082
Construction materials, fuels and instruments	84,808	231,832
Finished goods and goods for resale	57,455	49,050
Other inventories	210,316	217,645
Provision for inventory obsolescence	(2,874)	-
Total	544,087	859,609

Provision for inventory obsolescence is recorded as other operating expenses in the Consolidated Statement of Operations.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

13. Accounts Receivable

Accounts receivable as of December 31, 2005 and 2004 comprised the following:

	2005	2004
Trade receivables – telecommunication services	2,521,055	2,449,797
Provision for impairment of receivables	(1,225,044)	(1,311,923)
Total	1,296,011	1,137,874

Accounts receivable for telecommunication services detailed by major customer groups were as follows:

	2005	2004
Residential customers	934,046	800,840
Corporate customers	482,771	406,215
Government customers	146,781	171,067
Tariff compensation from the state budget	957,457	1,071,675
Total	2,521,055	2,449,797

The Company invoices its governmental and corporate customers on a monthly basis. For residential customers the Company sends monthly payment requests and substantially relies upon these customers to remit payments based on the received payment requests. All customer payments are based upon tariffs, denominated in Roubles, in effect at the time the calls are made.

As of December 31, 2005 debt for tariff compensation from the state budget related to granting privileges to certain categories of subscribers amounted to 38% of total accounts receivable (2004 - 44%).

In 2005 the Company collected from federal budget accounts receivable for tariff compensation of 74,678.

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

	2005	2004
Balance at January 1	1,311,923	760,531
Provision for the year	12,020	599,653
Trade receivables write-off	(98,899)	(44,681)
Provision disposal due to sale of subsidiary	-	(3,580)
Balance at December 31	1,225,044	1,311,923

The impairment loss for 2005 in the amount of 12,020 (2004 – 599,653) was recognized in the Consolidated Statement of Operations.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

14. Other Current Assets

As of December 31, 2005 and 2004 other current assets comprised the following:

	2005	2004
VAT receivable	856,914	1,128,487
Accounts receivable for non-core activities	259,085	119,632
Deferred expenses	151,866	106,449
Prepayments and advance payments	133,534	151,638
Prepaid income tax	38,813	42,203
Other prepaid taxes	20,346	31,702
Settlements with personnel	13,981	23,286
Short-term loans given	3,869	3,743
Other	99,249	87,629
Total	1,577,657	1,694,769

15. Cash and Cash Equivalents

As of December 31, 2005 and 2004 cash and cash equivalents comprised the following:

	2005	2004
Cash at bank and on hand	1,308,670	422,003
Short-term deposits	30,043	182
Total cash and cash equivalents	1,338,713	422,185

Interest rate on short term deposits is 7.5% per annum.

16. Significant Non-Cash Transactions

In 2005 the Company received telecommunication equipment under leasing terms in the amount of 374,114 (2004 – 593,878).

Gross book value of property, plant and equipment, which were received on vendor financing terms in 2005, amounted to 423,372 (2004 – 400,849).

The Company received equipment contributions in 2005 in the amount of 13,266 (2004 – 12,166)

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

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

17. Share Capital

The total number of outstanding shares comprises:

	Number of shares outstanding (thousands)	Par value	Carrying value
As at December 31, 2003	327,953	1,639,765	3,853,690
Preference	81,983	409,917	963,366
Ordinary	245,970	1,229,848	2,890,324
As at December 31, 2004	327,953	1,639,765	3,853,690
Preference	81,983	409,917	963,366
Ordinary	245,970	1,229,848	2,890,324
As at December 31, 2005	327,953	1,639,765	3,853,690

All shares have a par value of 5 Roubles. The difference between the total par value and the total carrying value of share capital represents the effects of inflation accumulated through January 1, 2003.

The ordinary shareholders are entitled to one vote per share.

Preference shares give the holders the right to participate in general shareholders' meetings without voting rights except in instances where decisions are made in relation to re-organization and liquidation of the Company, and in relation to changes and amendments to the Company's charter which restrict the rights of preference shareholders. The preference shares have no rights of redemption or conversion but carry non-cumulative dividends per share of 10% of the Russian accounting net income for the year. If the Company fails to pay the above mentioned dividends, or has no profits in any year, the preferred shareholders have the right to vote in the general shareholders' meeting. Owners of the preferred shares have the right to participate in and vote on all issues within the competence of general meetings following the annual general meeting at which a decision not to pay (or to pay partially) dividends on preferred shares has been taken. Annual amount of dividends on preference shares may not be less than dividends on ordinary shares. The preference shareholders participate in earnings along with ordinary shareholders. Accordingly, the Company's preferred shares are considered participating equity instruments for the purpose of earnings per share calculations (refer to Note 28).

In case of liquidation, the property remaining after settlement with creditors, payment of preferred dividends and redemption of the par value of preferred shares is distributed among preferred and ordinary shareholders proportionately to the number of owned shares.

Distributable earnings of the parent company are limited to its retained earnings, as mandated by the statutory accounting rules. Statutory retained earnings of the Company as of December 31, 2005 and 2004 amounted to 10,764,020 and 8,890,265, respectively.

In accordance with the Russian legislation, dividends may only be declared to the shareholders of the Company from net income as shown in the Company's Russian statutory financial statements. The Company reported net income of 2,261,360 and 2,056,268 in its statutory financial statements in 2005 and 2004, respectively.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

17. Share Capital (continued)

Dividends were declared in 2005 in respect of 2004 to holders of ordinary shares and preference shares of Rouble 1.3779 per ordinary share (2004 – Rouble 0.9186 per ordinary share) and Rouble 2.5082 per preference share (2004 – Rouble 2.4510 per preference share). See also Note 29.

In October 1997 the Company registered Level 1 American Depositary Receipts (ADR). Each ADR represents 2 shares of common stock of the Company.

The following table represents ADR registration for 2003-2005:

	ADR (quantity)	Ordinary Shares Equivalent (quantity)	Ordinary Shares %	Charter Capital %
December 31, 2003	12,757,592	25,515,184	10.37%	7.78%
Additions 2004	4,900,278	9,800,556	-	-
December 31, 2004	17,657,870	35,315,740	14.36%	10.77%
Additions 2005	4,536,988	9,073,976	-	-
December 31, 2005	22,194,858	44,389,716	18.05%	13.54%

Currently ADR are traded on the following stock markets:

Stock market	CUSIP(WKN)	ADR ticker	ISIN
Over-the-counter (OTC) market (USA)	928660109	VLGAY	
Frankfurt Stock Exchange (FSE)	910415	NZH	US9286601094
Berlin Stock Exchange (BerSE)	910415	NZH	US9286601094
Xetra	910415	NZH	US9286601094
Stuttgart Stock Exchange (SSE)	910415	NZH	US9286601094

The Company’s shareholding structure as of December 31, 2005 was as follows:

	Ordinary shares		Preference shares		Total
	Number (thousands)	%	Number (thousands)	%	
OJSC “Svyazinvest”	124,634	50.67	-	-	124,634
Other legal entities	65,156	26.49	60,820	74.19	125,976
ADR holders	44,390	18.05			44,390
Individuals	11,790	4.79	21,163	25.81	32,953
Total	245,970	100	81,983	100	327,953

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

18. Borrowings

As of December 31, 2005 and 2004 borrowings comprised the following:

	Interest rate	Maturity date	2005	2004
Short-term borrowings				
Bank loans:				
Bank loans (Roubles)	10-17%	2006	559,153	2,522,522
Bank loans (US Dollars)	5%	2006	-	25,734
Bank loans (Euro)	6-8.5%	2006	76,982	168,743
Total bank loans			636,135	2,716,999
Accrued interest on bonds (Roubles)		2006	45,210	57,328
Vendor financing:				
Vendor financing (Roubles)	6-12.24%	2006	1,089	1,704
Vendor financing (US Dollars)	5.5-8%	2006	61	66
Vendor financing (Euro)	6.8-7.35%	2006	1	21,455
Vendor financing (Japanese yen)	5.91%	2006	-	3,755
Total vendor financing			1,151	26,980
Accrued interest on promissory notes (US Dollars)		2006	1,245	-
Total short-term borrowings			683,741	2,801,307
Long-term borrowings				
Bank loans:				
Bank loans (Roubles)	7-13.5%	2006-2009	2,890,246	3,578,169
Bank loans (Euro)	6.35-6.5%	2006-2009	307,200	178,586
Total bank loans			3,197,446	3,756,755
Bonds (Roubles)	8.6-14%	2006-2010	6,262,076	1,000,000
Vendor financing:				
Vendor financing (Roubles)	5.6-12.24%	2006-2007	169,187	260,206
Vendor financing (US Dollars)	5.5-8%	2006-2007	141,158	105,707
Vendor financing (Euro)	6.8-7.35%	2006-2007	259,251	251,152
Total vendor financing			569,596	617,065
Promissory notes (US Dollars)	5.97%	2006	260,420	699,230
Less: Current portion of long-term borrowings			(2,699,872)	(1,816,704)
Total long-term borrowings			7,589,666	4,256,346

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

18. Borrowings (continued)

As of December 31, 2005 short-term borrowings included interest payable in the amount of 162,284 (2004 – 171,477).

As of December 31, 2005 bank loans are secured by property, plant and equipment with the carrying value of approximately 8,182,160 (2004 – 8,918,000).

As of December 31, 2005, borrowings had the following maturity schedule:

Maturity date	Bank loans	Bonds	Vendor financing	Promissory notes	Total
2006	1,652,020	1,044,452	425,476	261,665	3,383,613
2007	757,411	-	106,710	-	864,121
2008	573,000	969,372	4,658	-	1,547,030
2009	851,150	2,152,295	6,199	-	3,009,644
2010 and after	-	2,141,167	27,704	-	2,168,871
Total	3,833,581	6,307,286	570,747	261,665	10,973,279

The Company’s borrowings are denominated in the following currencies:

Currency	2005	2004
Russian Roubles	9,926,961	7,419,929
Euro	643,434	619,936
US dollars	402,884	830,737
Japanese yen	-	3,755
Total	10,973,279	8,874,357

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

Short-term borrowings

Bank Loans

Most of short-term borrowings denominated in Roubles represent bank loans received to finance working capital. Most of these loans are collateralized with telecommunications equipment.

AB Gazprombank CJSC

Short-term borrowings from Gazprombank represent Rouble denominated loans received in 2005. The loans bear interest of 11-12%. As of December 31, 2005, the outstanding amount was 504,671. The loans are not secured.

OJSC Vneshtorgbank

In October 2005 the Company entered into a loan agreement with Vneshtorgbank. The total amount of 39,447 was outstanding as of December 31, 2005. The loan bears interest of 13% per annum. The loan is secured with property, plant and equipment valued at 79,472.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

18. Borrowings (continued)

Long-term loans and borrowings

Bank Loans

OJSC Vnesheconombank

In 1995-1996, the Ministry of Finance of the Russian Federation provided long-term financing to the Company to purchase telecommunications equipment from various foreign vendors. Vnesheconombank acted as the agent on behalf of the Government of Russian Federation. At December 31, 2005 the outstanding amount of principal part of these loans was 111,142. The loans are denominated in EURO. The interest under these agreements is accrued at floating rate Plafond C, which in 2005 approximated 6.5 %, plus 2 % per annum. Interest payable as of December 31, 2005 included in short-term liabilities equaled to 75,316. The principle debt outstanding is presented as short-term part of long-term liabilities. The loan is not secured.

As described in Note 30 “Contingencies and operating risks” in July 2005 the Company received a claim for immediate repayment of outstanding amount overdue to the bank.

OJSC Sberbank

Long-term borrowings from Sberbank represent Rouble denominated loans received in 2004-2005. The loans mature in 2007-2009. The loans bear interest of 11.5-13%. As of December 31, 2005, the outstanding amount was 2,416,690. The loans are secured with property, plant and equipment valued at 4,799,608.

Foundation «Sozidanie»

Long-term borrowing from Foundation “Sozidanie” represents a Rouble denominated loan received in August 2005. The loan matures in July 2008. The loan agreement does not provide for interest payments thus the amount of liability as at December 31, 2005 was reported at the present value of future payments using a discount factor of 12.24%, which approximates a weighted average interest rate on the Company’s similar interest bearing borrowings obtained in appropriate periods. The amount outstanding as of December 31, 2005 was 54,308. This loan is not secured.

OJSC ACB Svyazbank

Long-term borrowings from ACB Svyazbank mostly represent Rouble denominated loans received in 2005. The loans mature in 2007. The loans bear interest of 11-12%. As of December 31, 2005 the outstanding amount was 102,000. The loans are secured with property, plant and equipment valued at 159,036.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

18. Borrowings (continued)

Long-term loans and borrowings (continued)

Bank Loans (continued)

OJSC AK Bars

In October 2003 the Company entered into a loan agreement with OJSC “AK Bars” totaling 185,000. The loan bears interest of 13% per annum. As of December 31, 2005 the outstanding amount was 108,096. This loan matures in October 2006. The loan is secured with property, plant and equipment valued at 314,995.

Banque Societ  General Vostok CJSC

Borrowings from Societ  General Vostok CJSC mostly represent euro denominated loans received in May 2005. The loans mature in September 2006. The loans bear interest of 6.35% per annum. As of December 31, 2005 the outstanding amount was 188,017. The loans are secured with property, plant and equipment valued at 415,877.

International Moscow Bank CJSC

In August 2004, the Company entered into a loan agreement with International Moscow Bank. The total amount of 72,000 was outstanding as of December 31, 2005. The loan bears interest of 13.5% per annum. The loan matures in August 2006. The loan is secured with property, plant and equipment valued at 196,869.

Bonds

In February 2003, the Company registered the issue of 1,000,000 interest-bearing bonds, series VT-1, par value of 1,000 Roubles each. The bonds have 12 quarterly coupons. Coupon effective interest rate is set at 13.98% per annum. The bonds mature in 1,096 days from the date of issue in February 2006.

In December 2005, the Company registered the issue of 3,000,000 interest-bearing bonds, series VT-2, par value of 1,000 Roubles each. The effective interest rate is set at 8.64% per annum. The bonds mature in 5 years from the date of issue in December 2010. These bonds do not provide put options.

In December 2005, the Company registered the issue of 2,300,000 interest-bearing bonds, series VT-3, par value of 1,000 Roubles each. The effective interest rate is set at 9% per annum. The bonds mature in 5 years from the date of issue in December 2010. These bonds do not provide put options.

Vendor financing

Alcatel

The Company’s long-term liabilities to Alcatel represent amounts payable for the telecommunication equipment under contracts signed in 2004-2005 and totaling to 259,238. The amounts payable under these agreements are denominated in Euro. These agreements bear an effective interest rate of 6.37%. Equipment received under these agreements is pledged to the supplier until the final payment is made.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

18. Borrowings (continued)

Long-term loans and borrowings (continued)

Vendor financing (continued)

BETO-Huawei

In 2004 the Company entered into several agreements with Beto-Huawei denominated in US Dollars, under which it delivered telecommunication equipment to the Company. These agreements bear an effective interest rate of 6.5%. The amount outstanding as of December 31, 2005 was 32,369. Equipment received under these agreements is pledged to the supplier until the final payment is made.

NPO ATS

In 2004-2005 the Company entered into several agreements with NPO ATS, under which it delivered telecommunication equipment to the Company. These agreements bear an effective interest rate of 6.5-12.24%. The amount outstanding as of December 31, 2005 was 25,432. Equipment received under these agreements is pledged to the supplier until the final payment is made.

ALSiTEK

In 2004-2005 the Company entered into several agreements with ALSiTEK, under which it delivered telecommunication equipment to the Company. These agreements bear an effective interest rate of 12.24%. The amount outstanding as of December 31, 2005 was 57,496. Equipment received under these agreements is pledged to the supplier until the final payment is made.

Metrosvyaz Limited

In April 1999 the Company entered into an agreement with Metrosvyaz Limited totaling 3,370,000 US dollars under which Metrosvyaz Limited delivered telecommunication equipment to the Company. This agreement bears an effective interest rate of 11%. The amount outstanding as of December 31, 2005 was 100,032. Equipment received under these agreements is pledged to the supplier until the final payment is made.

Promissory Notes

In December, 2004 the Company purchased Amdocs Billing Suite software from IBM Eastern Europe/Asia. In this connection the Company issued US dollar denominated promissory notes in the amount of 721,394. The outstanding amount of these notes as at December 31, 2005 was 260,420.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

19. Finance Lease Obligations

The Company has finance lease contracts for telecommunication equipment. Future minimum lease payments under finance lease contracts together with the present value of the net minimum lease payments as of December 31, 2005 and 2004 are as follows:

	2005		2004	
	Minimum lease payments	Present value of payments	Minimum lease payments	Present value of payments
Current portion	536,921	359,300	531,944	345,720
2 to 5 years	930,892	727,768	934,075	698,769
Total minimum lease payments	1,467,813		1,466,019	
Less amounts representing finance charges	(380,745)	-	(421,530)	-
Present value of minimum lease payments	1,087,068	1,087,068	1,044,489	1,044,489

In 2005 and 2004, the Company’s primary lessors were OJSC “RTC-Leasing” and LLC “Promsvyazleasing”. In 2005, the effective interest rate on lease liabilities ranged from 16.03% to 36.36% per annum (2004 - 17.5% to 39% per annum).

OJSC “RTC-Leasing” purchases telecommunication equipment from domestic and foreign suppliers and provides such equipment to the Company under finance lease agreements. The Company’s obligations under finance leases to OJSC “RTC-Leasing” as of December 31, 2005 amounted to 1,057,915 (2004 – 929,232). Further, the Company guarantees to OJSC “RTC-Leasing” obligations under these purchase agreements (refer to Note 30).

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

As of December 31, 2005 finance lease obligations denominated in foreign US dollars and Euro amounted to 38 and 67, respectively (2004 – 12,819 and nil, respectively).

20. Accounts Payable, Accrued Expenses and Advances Received

As of December 31, 2005 and 2004 accounts payable and other current liabilities comprised the following:

	2005	2004
Accounts payable for capital investments	894,119	1,285,607
Trade accounts payable	629,470	363,182
Advances received from subscribers	432,425	492,702
Salaries and wages	431,708	356,890
Other accounts payable	186,814	94,385
Total	2,574,536	2,592,766

Accounts payable for capital investments in the amount of 35,567 and 59,128 included in trade payables as of December 31, 2005 and 2004, respectively, are denominated in Euro.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

21. Taxes Payable

As of December 31, 2005 and 2004, taxes payable comprised the following:

	2005	2004
Value-added tax	630,331	565,540
Property tax	124,708	102,282
Personal income tax	16,161	12,974
Unified social tax	40,240	45,789
Other taxes	1,272	4,365
Total	812,712	730,950

Included in value added tax payable is the amount of 406,898 (2004 – 374,786), which represents deferred value added tax, that is payable to the tax authorities when the underlying receivables are recovered or written off.

Starting January 1, 2006 amendments to the Tax Code relating to rules of determination of the taxable base were introduced. These are described in Note 34 “Subsequent Events”.

22. Pensions and Other post-employment benefit plans

In addition to statutory pension benefits, the Company also contributes to post-employment benefit plans, which covers most of its employees.

The defined benefit pension plan provides old age retirement pension and disability pension. 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 specific to each branch of the Company. According to the formula the benefits depend on a number of parameters, including the relative pay of participants and their length of service in the Company at retirement. The benefits do not vest until and are subject to the employee retiring from the Company on or after the above-mentioned ages.

Non-government pension fund Telecom-Soyuz, which is related to the Company (Note 32), maintains the defined benefit pension plan. The Company makes contributions to the pension fund in the amount set forth in the agreement with the pension fund.

The Company further provides other long-term employee benefits such as a death-in-service payments and lump-sum payment upon retirement of a defined benefit nature.

Additionally the Company provides financial support of a defined benefit nature to its old age and disabled pensioners.

As of December 31, 2005 there were 47,231 active participants to the defined benefit pension plan of the Company (as of December 31, 2004 – 49,215).

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

22. Pensions and Other post-employment benefit plans (continued)

As of December 31, 2005 and 2004 the net liabilities of defined benefit pension and other post-employment benefit plans comprised the following:

	2005	2004
Present value of defined benefit obligation	2,043,424	1,519,646
Fair value of plan assets	(281,887)	(220,960)
Present value of unfunded obligations	1,761,537	1,298,686
Unrecognized past service cost	(682,801)	(618,738)
Unrecognized actuarial (losses)/gains	(251,344)	29,486
Net pension liability in the balance sheet	827,392	709,434

As of December 31, 2005 management estimated employees’ average remaining working life at 10 years (2004 - 10 years).

The amount of net expense for the defined benefit pension and other post-employment benefit plans recognized in 2005 and 2004 is as follows:

	2005	2004
Interest cost	145,150	124,364
Service cost	84,283	72,335
Expected return on plan assets	(17,178)	(14,751)
Actuarial gains/(losses)	-	-
Amortization of past service cost	83,365	74,362
Past service cost recognized in current year	63,327	-
Curtailment or final settlement effect	21,552	-
Net expense for the defined benefit pension plan	380,499	256,310

The movements in the net liability for defined benefit pension and other post-employment benefit plans in 2005 and 2004 are as follows:

	2005	2004
Net liability at January 1	709,434	552,420
Net expense for the year	380,499	256,310
Contributions	(262,541)	(99,296)
Net liability at December 31	827,392	709,434

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

22. Pensions and Other post-employment benefit plans (continued)

As of December 31, 2005 and 2004 the principle actuarial assumptions of defined benefit pension and other post-employment benefit plans were as follows:

	2005 Per annum	2004 Per annum
Discount rate	7%	9.18%
Expected return on plan assets	7.05%	9.33%
Future salary increases	8.15%	9.18%
Relative pay increase (career progression)	1%	1%
Rate used for calculation of annuity value	6%	6%
Increase in financial support benefits	5%	6%
Staff turnover	5%	5%
Mortality tables (source of information)	USSR 1985/86	Russia 1998

Movements in the net assets of defined benefit pension plans and other post-employment benefit during 2005 and 2004 were as follows:

	2005	2004
Fair value of plan assets at January 1	220,960	130,070
Actual return on plan assets	19,158	3,205
Employer contributions	262,541	99,296
Settlements	(175,220)	-
Benefits paid	(45,552)	(11,611)
Fair value of plan assets at December 31	281,887	220,960

During 2005 the Company introduced changes to the defined benefit pension plans, thus extending its liabilities under pension agreements. These additional benefits vested immediately.

Actual return on plan assets for 2005 was 10.4%.

As of December 31, 2005 assets of defined benefit pension and other post-employment benefit plans included shares of the Company which represented 0.04% of the total plan assets (as of December 31, 2004 – 0.15%).

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

23. Revenues

Revenues for the year ended December 31, 2005 and 2004 comprised the following:

By revenue types	2005	2004
Local telephone calls	7,482,458	5,493,216
Long distance telephone services – domestic	6,147,983	6,189,303
Cellular services	2,945,721	2,723,029
Installation and connection fees	1,443,219	1,487,088
New services	1,253,933	765,079
Revenues from national operators	1,154,194	1,128,805
Long distance telephone services – international	787,839	821,065
Radio and TV broadcasting	501,134	508,474
Rent of telephone channels	388,615	280,632
Data transfer and telematic services	225,810	186,985
Documentary services	45,105	60,778
Other telecommunications services	746,478	670,883
Other revenues	633,744	651,206
Total	23,756,233	20,966,543

Beginning from January 1, 2005 the Company changed the presentation in financial statements of local traffic (subscribers’ calls of the operator on mobile telephone numbers is rated by operators as local telephone calls by local calls tariffs). Therefore, traffic in the amount of 221.8 mln. minutes which previously would have been presented as domestic long distance calls is presented as local telephone calls. The total amount of revenue reclassified from domestic long distance calls to local telephone calls amounted to 33.3 mln. Roubles.

The Company identifies revenue by the following major customer groups:

Customer groups	2005	2004
Residential customers	12,886,110	12,255,872
Corporate customers	9,200,435	7,143,513
Government customers	1,669,688	1,567,158
Total	23,756,233	20,966,543

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

24. Other Operating Expenses

Other operating expenses, net comprised the following:

	2005	2004
Lease of premises	319,376	179,934
Agency fees	280,780	203,140
Fire and other security services	230,974	192,079
Cost of goods sold	199,437	194,332
Universal service fund payments	165,558	-
Non-commercial partnership expenses (Note 32)	162,232	150,100
Advertising expenses	130,655	129,064
Audit and consulting fees	90,930	84,432
Charitable contributions	80,822	81,994
Insurance	72,910	85,048
Business travel expenses and representation costs	71,851	54,737
Bank services fees	55,528	47,574
Education expenses	52,218	43,725
Buildings maintenance	50,608	90,189
Auxiliary production services	36,984	30,243
Transportation services	28,792	29,550
Post services	26,848	11,570
Civil Defense	8,133	26,822
Payments to Gossvyaznadzor	-	104,313
Other expenses	209,810	271,298
Total	2,274,446	2,010,144

In 2005 the Company incurred an expense on payments to Universal service fund. These payments are prescribed by the Federal Law on Communications and Government Decree # 243 of April 21, 2005. Payments are calculated as 1.2% of the revenues from the telecommunication services less revenues from interconnection services. Related contingency is disclosed in Note 30.

Other expenses include expenses related to fines and penalties, social expenditure, billing and cash collection services and other operating expenses.

25. Interest Expense, net

Interest expense, net for the years ended December 31, 2005 and 2004 comprised the following:

	2005	2004
Interest income	22,942	9,825
Interest expense on loans	(632,854)	(408,095)
Interest expense accrued on finance leases	(225,890)	(216,075)
Interest expense on vendor financing	(7,730)	(29,613)
Total	(843,532)	(643,958)

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

26. Gain on Sale of Subsidiaries, Associates and Other Investments

Gain from sale of subsidiaries, associates and other investments for the years ended December 31 comprised the following:

	2005	2004
Gain on sale of CJSC “Samarasvyazinform”	21,703	-
Gain on sale of OJSC “Telesot”	6,851	-
Gain on sale of CJSC “Aktionerny investitsionno-kommerchesky promyshlenno-stroitelny bank”	5,329	-
Gain on sale of CJSC “Sotovaya svyaz Mordovii”	4,805	-
Gain on sale of LLC “Udmurtskiye Sotovie Seti-450”	-	42,770
Gain on sale of CJSC “Sotel”	-	17,693
Gain on sale of LLC “Vyatskaya Sotovaya Svyaz”	-	12,452
Gain on sale of other investments	2,044	8,074
Other gain on investments	1,110	7,155
Total	41,842	88,144

27. Income Tax

Income tax charge for the years ended December 31, 2005 and 2004 comprised the following:

	2005	2004
Current income tax expense	(1,073,611)	(1,145,707)
Prior year income tax adjustments	(5,776)	22,709
Deferred tax expense	(312,234)	(44,259)
Total income tax for the year	(1,391,621)	(1,167,257)

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

	2005	2004
Profit before income tax	3,992,410	3,582,303
Statutory income tax rate	24%	24%
Theoretical tax charge at statutory income tax rate	(958,179)	(859,753)
Increase (decrease) resulting from the effect of:		
Prior-year income tax adjustments	(5,776)	22,710
Non-taxable income	30,054	43,527
Non-deductible expenses	(457,720)	(373,741)
Total income tax charge for the year	(1,391,621)	(1,167,257)
Effective tax rate	35%	33%

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

27. Income Tax (continued)

The composition of deferred income tax assets and liabilities as of December 31, 2005 and 2004 was as follows:

	As at December 31, 2003	Origination and reversal of temporary differences	Sale of subsidiaries	As at December 31, 2004	Origination and reversal of temporary differences	As at December 31, 2005
<i>Deferred tax assets</i>						
Accounts payable and accrued liabilities	26,289	89,299	-	115,588	5,531	121,119
Accounts receivable	91,267	89,916	-	181,183	(111,690)	69,493
Loans and Borrowings	76,343	(18,767)	-	57,576	(28,152)	29,424
Finance Lease Obligations	19,786	(19,786)	-	-	26,547	26,547
Total deferred tax assets	213,685	140,662	-	354,347	(107,764)	246,583
<i>Deferred tax liabilities</i>						
Fixed Assets	(1,054,401)	(213,028)	4,475	(1,262,954)	(186,654)	(1,449,608)
Intangible assets	(52,974)	(17,806)	-	(70,780)	(24,403)	(95,183)
Inventories	(7,622)	(1,055)	-	(8,677)	8,164	(513)
Effect from investments valuation	(55,694)	50,189	-	(5,505)	(4,797)	(10,302)
Finance Lease	-	(3,220)	-	(3,220)	3,220	-
Total deferred tax liabilities	(1,170,691)	(184,920)	4,475	(1,351,136)	(204,470)	(1,555,606)
Deferred Tax Liabilities, net	(957,006)	(44,258)	4,475	(996,789)	(312,234)	(1,309,023)

In the context of the effective tax legislation, tax losses and current tax assets of the different companies may not be set off against current tax liabilities and taxable profits of other companies and, accordingly, taxes may accrue even where there is a net consolidated tax loss. Therefore, deferred tax asset of one company of the Company is not offset against deferred tax liability of another company.

Accordingly, the mentioned above differences were presented as follows in the balance as of December 31, 2005 and 2004:

	2005	2004
Deferred Tax Asset	27,049	24,814
Deferred Tax Liability	(1,336,072)	(1,021,603)
Deferred tax liability, net	(1,309,023)	(996,789)

The movement in deferred tax asset for the years ended December 31, 2005 and 2004 was as follows:

	2005	2004
Deferred tax asset, at January 1	24,814	54,104
Deferred tax income (expense)	2,235	(29,290)
Deferred tax asset, at December 31	27,049	24,814

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

27. Income Tax (continued)

The movement in deferred tax liability for the years ended December 31, 2005 and 2004 was as follows:

	2005	2004
Deferred tax liability, at January 1	(1,021,603)	(1,011,110)
Deferred tax expense	(314,469)	(14,969)
Deferred tax liabilities of subsidiaries disposed	-	4,476
Deferred tax liability at December 31	(1,336,072)	(1,021,603)

28. Earnings per Share

Earnings per share are calculated by dividing the net income attributable to shareholders by the weighted average number of shares in issue during the period.

The calculation of basic and diluted earnings per preferred and ordinary share is presented below (earnings per share data is stated in Roubles):

	2005	2004
Profit for the year attributable to equity holders of the parent	2,562,060	2,321,983
Weighted average number of shares outstanding (thousands) (see Note 17)	327,953	327,953
Basic and diluted earnings per share attributable to equity holders of the parent, Russian Roubles	7.81	7.08

The Company has no dilutive potential ordinary shares; therefore, the diluted earnings per share equal basic earnings per share.

29. Dividends Declared for Distribution

Dividends declared in 2005 based on 2004 results:

Dividends on ordinary shares – 1.3779 Roubles per share	338,921
Dividends on preference shares – 2.5082 Roubles per share	205,631
Total	544,552

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

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

30. Contingencies and Operating Risks

Operating Environment of the Company

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

Legal system

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 in legislation interpretation; 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 position or future results of operations.

In the nearest future the Company’s activity could be subject to judicial reform factors. No adjustments related to these uncertainties were recognized in the consolidated statements.

Taxation

Russian tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Company may be challenged by the relevant regional and federal authorities. Recent events within the Russian Federation suggest that the tax authorities are taking a more assertive position in its interpretation of the legislation and assessments and as a result, it is possible that transactions and activities that have not been challenged in the past may be challenged. As such, significant additional taxes, penalties and interest may be assessed. It is not practical to determine the amount of unasserted claims that may manifest, if any, or the likelihood of any unfavourable outcome. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years proceeding the year of review. Under certain circumstances reviews may cover longer periods.

Claims of tax authorities

Management believes that the Company’s tax liabilities for the current and preceding periods were properly calculated and presented in the financial statements in full. However, based on recent tax examinations of other entities of OJSC “Svyazinvest” Group, management believes, that there is a risk of receiving significant tax claims with respect to the matters, assuming varying interpretations of the tax regulations, in particular matters on settlements between operators for interconnection services. Management believes that the Company has appropriate arguments to litigate possible tax claims. Nevertheless, due to the absence of the established legal practices with respect to such claims legal proceedings currently are largely uncertain.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

30. Contingencies and Operating Risks (continued)

Insurance Coverage

During 2005, the Company did not maintain insurance coverage on a significant part of its property, plant and equipment, business interruption losses, or third party liability in respect of property or environmental damage arising from accidents relating to the Company’s property or the Company’s operations. Until the Company obtains adequate insurance coverage, there is a risk that losses resulting from destruction of certain assets could have a material adverse effect on the Company’s operations and financial position.

Legal Proceeding

In July 2005 the Ministry of Finance of the Russian Federation filed a claim against the Company demanding immediate repayment of debts outstanding to Vnesheconombank as of July 12, 2005 in the amount of 226,890 (6,637 thousand euro).

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

Licenses

Substantially all of the Company’s revenues are derived from operations conducted pursuant to licenses granted by the Russian Government. These licenses expire in various years ranging from 2006 to 2012. Suspension or termination of the Company’s main licenses or any failure to renew any or all of these main licenses could have a material adverse effect on the financial position and operations of the Company.

The Company renewed these licenses on a regular basis in the past, and believes that it will be able to renew licenses without additional cost in the normal course of business.

The Government of the Russian Federation is in process of liberalization of telecommunications market for which additional licenses on providing DLD/ILD has been granted to a number of alternative operators. It is possible that the Company’s future results of operations and cash flows could be materially affected by the increased competition in a particular period but the effect can not be currently determined.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

30. Contingencies and Operating Risks (continued)

Licenses (continued)

The Decision of the Russian Government # 87 “On Endorsement of the list of the names of communication services entered in licenses and the lists of license terms” of February 18, 2005 (amended as at December 29, 2005 # 837) prescribed types of connection services that are to be included into licenses and list of licensing terms. Licensing terms defined in previously issued licenses are effective unless they contradict the current regulations. The Company considered significant effect of new requirements related to the interconnection settlements, traffic transmission and mobile services on current licensing terms for licenses issued prior to January 1, 2004 and in November 2005, the Company submitted to Federal Service for Communications Supervision (Rossvyaznadzor) its request for changes and amendments to the existing License for provision of local, intercity telecommunications services in order to bring the License terms in compliance with the requirements set by Governmental Decree # 87 dated February 18, 2005. All necessary amendments to the licenses were received.

Guarantees Issued

The Company mainly guaranteed credit line facilities provided by Sberbank to OJSC “RTC-Leasing”, a lessor of telecommunication equipment, as of December 31, 2005 (Note 19). The total guarantees amounted to 2,241,045 (2004 – 1,308,567).

Universal service fund payments

Industry regulations effective as of December 31, 2005 did not provide clear guidance with respect to the method of calculation of the allocation to the fund that may lead to uncertainty in composition of the basis for such payments. Accordingly, there is a risk of incorrect calculation of the payments to this fund.

31. Contractual Commitments

Operating leases

The Company entered into office premises’ lease agreements. These non-cancelable leases have remaining terms between 1 and 44 years.

As of December 31, 2005 and 2004 the future minimum lease payments under non-cancelable operating leases are presented in the aggregate and for each of the following periods:

	<u>2005</u>	<u>2004</u>
Current Portion	45,348	43,909
From 2 to 5 years	16,213	18,964
Over 5 years	94,945	91,293
Total	<u><u>156,506</u></u>	<u><u>154,166</u></u>

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

31. Contractual Commitments (continued)

Finance Leasing

In 2005 the Company entered into several finance leases with OJSC “RTC-Leasing”. The equipment under these leases will be delivered in 2006. The cost of equipment acquired through these leases, inclusive of installation and other capitalizable services approximated to 684,043. The Company issued advances to the lessor under these agreements in the amount of 308,329 (see also Note 11).

Capital Investments

As of December 31, 2005 the Company has commitments for capital investments into modernization and expansion of its network in the amount of 40 (2004 – 109,794).

Acquisition of Intangible Assets

As of December 31, 2005 the Company has commitments for the purchase of intangible assets in the amount of 11,504 (2004 – 10,365).

32. Balances and Transactions with Related Parties

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

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

The nature of the related party relationships for those related parties with whom the Company entered into significant transactions or had significant balances outstanding at December 31, 2005 are detailed below.

Rendering Services

During the year ended December 31, 2005 and 2004 the Company rendered significant amount of services to the following related parties:

Related party	Relationship	Type of sales	Price determination method	2005	2004
OJSC "Rostelecom"	Controlled by OJSC "Svyazinvest"	Telecommunication services	Arms' length terms	845,405	790,363
CJSC "Samara Telecom"	Associate company	Telecommunication services, rent of premises	Arms' length terms	32,832	33,375
LLC "Rossvyazinform"	Associate company	Logistics support	Arms' length terms	14,764	-
CJSC "Saratov Mobile"	Associate company	Telecommunication services	Arms' length terms	14,112	11,718
CJSC "Rostelegraph"	Controlled by OJSC "Svyazinvest"	Telecommunication services	Arms' length terms	6,885	51,470

OJSC "VolgaTelecom"

Notes to Consolidated Financial Statements

(in thousands roubles)

32. Balances and Transactions with Related Parties (continued)

Purchases

During the year ended December 31, 2005 and 2004 the following related parties rendered significant amount of services to the Company:

Related party	Relationship	Type of sales	Price determination method	2005	2004
OJSC "Rostelecom"	Controlled by OJSC "Svyazinvest"	Telecommunication services	Arms' length terms	1,939,383	1,905,283
NPF "Telecom - Souyuz"	Controlled by OJSC "Svyazinvest"	Pension plans	Arms' length terms	262,380	58,952
OJSC "RTKomm.RU"	Controlled by OJSC "Svyazinvest"	Telecommunication services	Arms' length terms	225,608	147,619
OJSC "Svyazinvest"	Parent company	Dividends paid	Based on decision of Shareholders' meeting	174,733	108,514
Non-commercial partnership "Center for Research of Problems in Development of Telecommunications"	Controlled by OJSC "Svyazinvest"	Agent agreement	Contracted price	162,093	150,110
CJSC "Samara - Telecom"	Associate company	Telecommunication services, rent of premises	Arms' length terms	10,891	6,474

Settlements with Related Parties

Accounts receivable

As of December 31, 2005 and 2004 significant balances of accounts receivable from related parties were as follows:

Related party	Relationship	Type of receivables	2005	2004
OJSC "Informatsionnye Tehnologii Svyazy" (OJSC "Svyazintech")	Controlled by OJSC "Svyazinvest"	Advances given for software implementation services	140,726	-
Non-commercial partnership "Center for Research of Problems in Development of Telecommunications"	Controlled by OJSC "Svyazinvest"	Agent agreement	104,562	44,375
OJSC AKB "Svyaz-Bank"	Associate company	Bank services	84,333	39,739
CJSC "Nizhegorodskiy radiotelephone"	Associate company	Rent of premises, transport services	8,180	4,507

Accounts payable:

As of December 31, 2005 and 2004 significant balances of accounts payable to related parties were as follows:

Related party	Relationship	Type of payables	2005	2004
OJSC "Rostelecom"	Controlled by OJSC "Svyazinvest"	Telecommunication services	108,146	110,817
OJSC "RTKomm.RU"	Controlled by OJSC "Svyazinvest"	Telecommunication services	4,327	2,986
CJSC "Rusleasingsvyaz"	Controlled by OJSC "Svyazinvest"	Leasing services	1,575	1,921
CJSC "Samara Telecom"	Associate company	Telecommunication services	825	834
CJSC "Rostelegraph"	Controlled by OJSC "Svyazinvest"	Telecommunication services	554	1,848
NPF "Doverie"	Associate company	Rent of premises	165	192
CJSC "Registrator - Svyaz"	Associate company	Maintenance of shareholders' register	123	-

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

32. Balances and Transactions with Related Parties (continued)

OJSC Svyazinvest

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

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

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

OJSC Rostelecom

OJSC “Rostelecom”, a majority owned subsidiary of OJSC “Svyazinvest”, is the primary provider of domestic long distance and international telecommunications services in the Russian Federation. The annual expense associated with traffic carried by OJSC “Rostelecom” and terminated outside of the Company’s network is stated as interconnection charges. Further, OJSC “Rostelecom” uses the Company’s network to provide incoming long-distance and international traffic to its subscribers and partner operators. Changes in settlements with OJSC “Rostelecom” after January 1, 2006 are described in Note 34.

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. The Company also renders services to other state-owned entities. Certain entities financed by the Government budget are users of the Company’s network. These entities are generally charged lower tariffs as approved by the Federal Antimonopoly Agency 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.

Article 47 of the Federal Law # 126-FZ “On Communications” came into force starting January 1, 2005. Provisions of this article changed previously established pattern of settlements with subscribers for privileges granted for communication services. Under the old pattern the Company issued invoices to the privileged subscribers net of the amount of privilege, which was subsequently reimbursed by the state budget. The new pattern assumes that privileged subscribers pay for the services rendered in full and further receive a reimbursement directly from the state budget.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

32. Balances and Transactions with Related Parties (continued)

Transactions with Government Organizations (continued)

Government subscribers and tariff compensation accounted for approximately 44% of gross trade accounts receivable as of December 31, 2005 (2004 – 51%). Amounts outstanding from government subscribers and debt of social security organizations with regard to compensation of expenses related to granting privileges to certain category of subscribers, as of December 31, 2005 amounted to 1,104,238 (2004 – 1,242,742) (Note 13). Revenues from this category of subscribers are presented in Note 23.

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

Non-commercial partnership Centre for Research of the Problems in Development of Telecommunications (hereinafter “the Partnership”) is an entity OJSC “Svyazinvest” controls through its subsidiaries. The Company is a member of the Partnership and has an agreement with it, under which it provides funding for industry research and common administrative activities on behalf of the Company and other subsidiary 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, 2005 amounted to 162,232 (2004 – 150,100).

NPF Telecom-Soyuz

In 2005 the Company signed centralised pension agreements with NPF Telecom-Soyuz (see Note 22). OJSC “Svyazinvest” holds the majority in the Board of Directors of NPF Telecom-Soyuz (“the Fund”). Payments from the Company to the Fund in 2005 amounted to 262,541 (2004 – 99,296).

Compensation to Key Management Personnel

Key management personnel comprise members of the Management Board and the Board of Directors of the Company, totaling 20 and 27 persons as of December 31, 2005 and 2004, respectively. Total compensation to key management personnel included in “Wages, salaries, other employee benefits and payroll taxes” in the statement of operations amounted to 32,136 and 64,000 for the years ended December 31, 2005 and 2004, respectively, and consists of remuneration for management services.

33. Financial Instruments and risk management objectives and policies.

The Company’s principal financial instruments comprise bank loans, finance leases and cash and short-term deposits. The main purpose of these instruments is to raise finance for the Company’s operations. The Company has other financial assets and liabilities such as trade receivables and trade payables, which arise directly from its operations.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

33. Financial Instruments and risk management objectives and policies (continued)

Foreign Exchange Risk

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

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

As at December 31, 2005 the Company’s liabilities in foreign currency were 1,081,990 (2004 – 1,526,375), including liabilities denominated in US dollars 402,922 (2004 – 843,556) and Euro and other currencies 679,068 (2004 – 682,819).

For the period from January 1, 2004 to December 31, 2005 exchange rate of the Russian Rouble to US Dollar decreased by approximately 2.3% and exchange rate of the Russian Rouble to Euro decreased by approximately 7.9%. Possible decrease in the exchange rate of the Russian Rouble may lead to an increase in the amount of the Company’s borrowings, as well as will cause difficulties in attraction of funds including funds required for refinancing of the existing debt.

Interest Rate Risk

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

The following table presents as of December 31, 2005 and 2004 the carrying amount by maturity of the Company’s financial instruments that are exposed to interest rate risk:

As of December 31,2005:	< 1 year	1–5 years	> 5 years	Total
<i>Fixed rate</i>				
Short-term obligations	602,246	-	-	602,246
Long-term obligations	2,588,730	7,581,625	-	10,170,355
Finance lease obligations	359,300	727,768	-	1,087,068
Loans given	15,752	-	-	15,752
Short-term deposits	30,043	-	-	30,043
<i>Floating rate</i>				
Short-term obligations	81,495	-	-	81,495
Long-term obligations	111,142	8,041	-	119,183
As of December 31,2004:				
	<1year	1-5years	>5years	Total
<i>Fixed rate</i>				
Short-term obligations	2,601,606	-	-	2,601,606
Long-term obligations	1,704,430	4,206,288	20,288	5,931,006
Finance lease obligations	345,720	698,769	-	1,044,489
Loans given	18,283	-	-	18,283
Short-term deposits	182	-	-	182
<i>Floating rate</i>				
Short-term obligations	199,701	-	-	199,701
Long-term obligations	112,274	29,770	-	142,044

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

33. Financial Instruments and risk management objectives and policies (continued)

Interest Rate Risk (continued)

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

The Company has no significant interest-bearing assets other than those presented above.

Credit Risk

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

Financial assets, which are potentially subject to credit risk, consist principally of trade receivables. The carrying amount of accounts receivable, net of provision for impairment of receivables, represents the maximum amount exposed to credit risk. The Company has no significant concentrations of credit risk due to significance of the client base and regular monitoring procedures over customers' and other debtors' ability to pay debts. A part of accounts receivable is represented by debts of state and other non-commercial organizations. Recovery of these debts is influenced by political and economic factors, however, management believes that as of December 31, 2005 there is no significant risk of loss to the Company beyond the provision already recorded.

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

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

33. Financial Instruments and risk management objectives and policies (continued)

Fair Value

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

Set out below is the comparison by category of carrying amounts and fair values of all of the Company's financial instruments:

Financial instruments	2005		2004	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial Assets				
Investments in associates	119,980	119,980	110,096	110,096
Long-term investments available for sale	24,910	24,910	11,252	11,252
Long-term accounts receivable	5,083	5,083	3,308	3,308
Long-term borrowings given	15,752	15,752	18,283	18,283
Accounts receivable	1,296,011	1,296,011	1,137,874	1,137,874
Cash and cash equivalents	1,338,713	1,338,713	422,185	422,185
Total	2,800,449	2,800,449	1,702,998	1,702,998
Financial Liabilities				
Long-term bank loans	2,181,562	2,181,562	2,845,231	2,845,231
Long-term bonds	5,262,833	5,262,833	1,000,000	1,052,000
Long-term promissory notes	-	-	240,465	240,465
Long-term suppliers' credits	145,271	145,271	170,650	170,651
Long-term finance lease obligations	727,768	727,768	698,769	698,769
Accounts payable	3,571,889	3,571,889	3,548,781	3,548,781
Short-term bank loans	636,135	636,135	2,716,999	2,716,999
Short-term bonds	45,210	45,210	57,328	57,328
Short-term promissory notes	1,245	1,245	-	-
Short-term suppliers' credits	1,151	1,151	26,980	26,980
Current portion of long-term bank loans	1,015,884	1,015,884	911,524	911,524
Current portion of long-term bonds	999,243	1,007,243	-	-
Current portion of long-term promissory notes	260,420	260,420	458,765	458,765
Current portion of long-term suppliers' credits	424,325	424,325	446,415	446,415
Current portion of long-term finance lease obligations	359,300	359,300	345,720	345,720
Total	15,632,236	15,640,236	13,467,627	13,519,627

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

34. Subsequent Events

New provisions of the Federal Law on Communications

The legislative framework for the reform of the Russian telecommunications industry is the Federal Law on Communications of 2004. To implement the Federal Law on Communications, the Russian Government approved new rules and regulations for the interconnection and interaction of telecommunications networks, for the provision of local, intra-regional, DLD, and ILD telephone services, and other regulations for the provision of long-distance services, including licensing requirements for telecommunications operators. The transition to the new system of interaction on January 1, 2006 stems from these new requirements under Russian legislation.

New regulations required in pursuance of the Federal Law on Communications come into force starting January 1, 2006:

1. Decision of the government of the Russian federation no. 161 of March 28, 2005 on endorsing the Rules for connecting electric communication networks and for their interaction (with Amendments and Addenda of June 30, December 29, 2005)
2. Decision of the government of the Russian federation no. 310 of May 18, 2005 on the approval of Rules for Rendering Services of Local, Intra-Zone, Inter-City and International Telephone Communication (approved by Decision of the Government of the Russian Federation No. 310 of May 18, 2005) (with the Amendments and Additions of June 30, December 29, 2005).
3. Decision of the government of the Russian federation no. 242 of April 21, 2005 on the approval of the Rules for state regulation of tariffs on universal communications services (with the amendments and additions of October 24, 2005)
4. Order of the Ministry of Communications no. 97 of August 8, 2005 on Approval of the requirements to public switched telephone networks.
5. Order of the Ministry of Communications no. 98 of August 8, 2005 on Approval of the requirements to traffic transmission in public switched telephone networks.

Changes in settlements with OJSC “Rostelecom” in 2006

Prior to January 1, 2006 the Company, in accordance with the terms of its Addendum #1 to license for telecommunication services, rendered domestic long-distance (DLD) and international long-distance (ILD) services (“long-distance services”) to its customers. Revenues and receivables from rendering of the services were recognized as the Company’s revenues and receivables.

Under the previous system of interaction with operators, OJSC “Rostelecom” provided long-distance traffic transit services to the Company. The Company independently billed for long-distance services provided to its local network subscribers through its own subscriber billing systems. The Company settled with Rostelecom for long-distance call transit and termination services, and Rostelecom, in turn, paid the Company for call termination services. The Company performed settlements for international telecommunications services with subscribers by tariffs, set by OJSC “Rostelecom”, and settlements for intercity telecommunications services by tariffs, set by the Federal Antimonopoly Agency.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

34. Subsequent Events (continued)

Changes in settlements with OJSC “Rostelecom” in 2006 (continued)

Starting from 2006 the settlements between the Company and OJSC “Rostelecom” change. Domestic long-distance (DLD) and international long-distance (ILD) services will be rendered by OJSC “Rostelecom”. Revenues and receivables from rendering of the services will be recognized as OJSC “Rostelecom” revenues and receivables.

The Company and OJSC “Rostelecom” signed an agreement for the year 2006 combining elements as of an agency agreement as well as of a service contract, according to which the Company undertakes rendering the following services to OJSC “Rostelecom”:

- Subscriber orders’ processing services for access to intercity and international telecommunications services provided through the direct and delay operations.
- Billing processing services for intercity and international telecommunications services.
- Preparation, formation and storage of necessary data and reports;
- Agency services on collection of payments from subscribers and on call center support in the name and on behalf of OJSC “Rostelecom”.
- Claims administration, documents delivery.

In addition to the above mentioned contract the parties signed the agreement on network interconnections, under which the Company provides OJSC “Rostelecom” the services on traffic transmission and OJSC “Rostelecom” provides the Company connection services.

To comply with the new regulatory requirements, the Company must fulfill a number of conditions, including:

- technical conformity of its network to requirements set for DLD and ILD communication networks, including availability of interconnection points to its network in every federal administrative region of the Russian Federation; and
- operational readiness to provide long-distance services to any local network subscriber.

Fulfillment of these requirements would not lead to additional capital expenditure of the Company as major necessary capital expenditure was made in 2005.

Changes in settlements with interconnected operators

New legislative pronouncements effective January 1, 2006 significantly changed the scheme of settlements with interconnected operators.

Prior to January 1, 2006 settlements for interconnection services with the operators for local telephone services were of unilateral nature, and for intra-regional, DLD, and ILD telephone services interconnected operators received a part of the revenues from such services depending on the degree of their participation in the provision of a service.

Starting from January 1, 2006 settlements are of a mutual nature and consist of the following:

- point of connection set up;
- user fee for point of connection;
- fee per minute of traffic submitted through the network.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

34. Subsequent Events (continued)

Changes in settlements with interconnected operators (continued)

The changes will result in additional revenues from interconnection and traffic transmission as well as in additional costs related to payments to these operators for connection points set up, user fee and traffic transmission in the operators' network.

In order to meet the requirements of the new pattern of settlements the Company will incur additional capital expenditure. In first quarter of 2006 such expenditure amount to 84,000.

As of the beginning of April, 2006 the Company signed agreements of interconnection and traffic transmission with OJSC Rostelecom and OJSC Multiregional Transit-Telecom.

Currently the Company is undertaking the necessary renegotiation procedures with interconnection operators. The Company expects to finalize these procedures in June 2006.

Interconnection services are currently included into services regulated by the Government. As a consequence the interconnection fee, including the profitability level, is to be prescribed by the regulating body.

Significant Operator

In accordance with Order of the Federal Service for Communications Supervision (Rossvyaznadzor) no. 39 on October 21, 2005, no. 40 and 31 on October 24, 2005 and no. 52 on December 22, 2005 the Company is included into the Register of Communications services operators occupying an important position in the general-use communications network (Significant Operator).

An operator occupying an important position in the general-use communications network, is obliged to establish, for the purposes of ensuring indiscriminate access to the market of communications services under similar circumstances, equal conditions for connecting telecommunications networks and for letting through traffic for communications operators rendering similar services, as well as to supply information and to render connection services and the services involved in letting through the traffic to these operators under the same terms and of the same standard, like for his own structural subdivisions and/or for the affiliated persons.

An operator occupying an important position in the general-use communications network on the territories of several subjects of the Russian Federation shall establish the terms for connecting telecommunications networks and for letting through traffic separately on the territory of each subject of the Russian Federation.

The refusal of an operator occupying an important position in the general-use communications network to conclude a contract for connecting telecommunications networks is seen as inadmissible, with the exception of cases when the connection of the telecommunications networks and their interaction contradict the terms of the licenses issued to communications operators, or the legal normative acts determining the construction and the functioning of the uniform telecommunications network of the Russian Federation.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

34. Subsequent Events (continued)

Significant Operator(continued)

Prices for connection services and for services involved in letting through traffic rendered by operators occupying an important place in the general-use communications network are subject to state regulation. The list of connection services and services for letting through the traffic, the prices for which are subject to state regulation, as well as the procedure for their regulation, are established by the Government of the Russian Federation.

Rendering of Universal telecommunication service

Universal communication service is the communication service whose rendering to any user of communication service on the entire territory of the Russian Federation within a fixed term, of the established standard and at a reasonable price is obligatory for operators of the universal servicing. This service is to be rendered by operators of universal servicing who are selected in accordance with the results of a tender or are appointed in accordance with the Federal Law for every subject of the Russian Federation.

Tender for provision of telecommunication services in Povolzhie Federal District is scheduled for July-September, 2006. The Company intends to participate in this competition for provision of universal service. The Company intends to additionally appropriate the funds necessary for provision of the service.

If there are no applications for taking part in the competition, or if it is impossible to identify the winner, rendering of universal communications service shall be imposed by the Government of the Russian Federation at the presentation of the federal executive power body in the sphere of communications upon the Company as an operator occupying an important position in the general-use communications network. The Company, as the operator occupying an important position in the general-use communications network has no right to refuse the duty involved in rendering universal communications services imposed upon him.

Cancellation of charges for incoming calls

In March 2006 an amendment to the Federal Law on Communication was approved by the President. According to this amendment effective July 1s, 2006 the subscriber will not pay for a telephone connection established as a result of a call by another subscriber, except for the cases specifically mentioned in the Federal Law on Communication.

This change would mainly affect the settlements between the Company and mobile network operators.

Starting from the enforcement of this amendment the Federal Service on Tariffs will set tariffs for intra-regional services between the Company as a significant operator and mobile network operators. Subsequent to that the Company would renegotiate the agreements with these operators.

The Company envisages increase in revenues from intra-regional services in the second half of 2006 and increase in costs related to calls termination on mobile networks.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

34. Subsequent Events (continued)

Tariffs for telecommunication services

Under Decree of the Government of the Russian Federation # 627 dated October 19, 2005 settlement rates (including rates for call origination, termination, and transit) for operators occupying a significant position in the public communications network (significant operators) are regulated by the Federal Service for Communications Supervision (Rossvyaznadzor) under the supervision of the Federal Tariff Service (FST) in accordance with the Federal Law on Natural Monopolies.

In November 2005 the Company submitted its proposed tariffs to Rossvyaznadzor for approval. The tariffs were determined based on the 2005 rates. Owing to the absence of unified methodology on determination of economically justifiable costs the tariffs were not approved by the supervising body. Prior to setting such tariffs by the Federal Service for Communications Supervision the Company is allowed to determine these tariffs independently.

In December 2005 the Federal Service for Communications Supervision determined the amount of the compensation surcharge to be included in rates for call origination services provided by the Company as a significant operator. The surcharge is set at 0.54 Roubles per minute and is effective starting January 1, 2006. The compensation surcharge is supposed to cover the difference between an operator's income and economically justified costs in providing local and intra-regional communication services.

Impact of new rules for rendering of telecommunication services on financial statements

The Company's management expects that new rules of provision of telecommunication services will influence both revenues and expenses of the Company, however, the Company cannot reliably measure the effect of such changes on the financial position and financial results of the Company.

Value Added Tax

Federal Law No. 119-FZ dated July 22, 2005, introduced amendments to the Tax Code effective January 1, 2006. According to these amended provisions VAT taxable base on sales of goods (rendering of services) is determined at the earliest of:

- date of goods (services) shipment (rendering);
- date of payment (partial payment) for subsequent delivery of goods (services), transfer of rights of ownership.

OJSC “VolgaTelecom”

Notes to Consolidated Financial Statements

(in thousands roubles)

34. Subsequent Events (continued)

Purchase of share in OJSC “National television company “Zvezda”

In January 2006 the Company purchases 352 ordinary shares of OJSC “National television company “Zvezda” for 47,681. The purchase was approved by the Board of Directors decision dated January 19, 2006. Total share of the Company in the investee amounted to 1.668%.

The majority shareholder of OJSC “Zvezda” is LLC “NTK “Zvezda”, who owns 95% of its ordinary shares. 55% share of LLC “NTK “Zvezda” belongs to the Federal governmental institution “National television and broadcasting studio” of the Ministry of Defense.

Dividends

The Board of Directors of the Company proposed the following distribution of profits to the Annual Shareholders’ meeting to be held on June 26, 2006:

Dividends for 2005 proposed for approval

Dividends on ordinary shares – 1.4744 Roubles per share	362,646
Dividends on preference shares – 2.7583 Roubles per share	226,136
Total	588,782

Employee Redundancy Program

In accordance with the Employee Redundancy Program approved by the Company’s Management Board on December 2, 2005 the Company dismissed 1,470 employees paying compensations totaling 12,848 between December 31, 2005 and the date of the authorisation of these financial statements for the issue.

Bonds issue

On April 3, 2006 the Board of Directors approved the issue of 3,000,000 interest-bearing bonds, par value 1,000 Roubles each. The bonds have 28 quarterly coupons. Coupon payments are made on each 91 day starting from the date of placement. The interest rate will be determined based on tender that will be held as at the date of placement. The bonds mature as follows: 20% of par value on 1,820th day, 20% of par value on 2,002nd day, 20% of par value on 2,184th day, 20% of par value on 2,366th day, and 20% of par value on 2,548th day starting from the date of issue.

Consolidation of cellular subsidiaries

On March 15, 2006 the Board of Directors approved the Strategy of Development for Cellular Segment of the Company. According to this strategy the Company intends to merge its cellular subsidiaries on the basis of its major subsidiary – CJSC “Nizhegorodskaya Sotovaya Svyaz” – and create a united mobile operator in Povolzhie region.