

**REPORT**  
**of the Auditing Committee**  
**Based on the Results of Checking the Financial and Economic Operation of the Open**  
**Joint-Stock Company North-West Telecom (OJSC N.W. Telecom)**  
**for the year 2009**

Moscow

12<sup>th</sup> May 2010

The Auditing Committee of OJSC N.W. Telecom elected by the general meeting of the shareholders on 22<sup>nd</sup> June 2009, consisting of the following members:

*Chairperson of the Committee* O.G. Korolyova,

*members of the Committee* V.V. Bekin, S.N. Bocharova, T.Yu. Zubova,  
Yu.A. Klyus, P.E. Puchkov,

guided by the powers established by the Federal Law On Joint-Stock Companies, the Articles of Association of OJSC N.W. Telecom and the Provisions on the Auditing Committee, has carried out an audit of the financial and economic activities of the Company for the year 2009.

The audit has been carried out in accordance with the decision of the Auditing Committee of OJSC N.W. Telecom (Minutes of the Meeting No. 5 of 17<sup>th</sup> February 2010) in the period from 15<sup>th</sup> March till 20<sup>th</sup> April 2009 in respect of the Company's annual accounts and reports for the fiscal year from 1<sup>st</sup> January till 31<sup>st</sup> December 2009 in the following areas:

- observing the established procedure of book-keeping and submission of financial reports;
- auditing the legality of decisions and actions of the Company's executive bodies, including concluded contracts and made transactions;
- checking the observance of the legal acts in the performance of the financial and business operations;
- analysis of internal control organization.

The analysis was carried out on the basis of the documents, accounting and tax ledgers, and explanations provided by the management of the Company, as well as the information disclosed on the web site (<http://www.nwtelecom.ru>). The analysis included a study of the disclosure in the financial (accounting) reports of information on the financial and economic activities, an evaluation of the accounting principles and methods, as well as the rules of preparing the financial (accounting) reports and the annual report.

Methods of total and sampling audit of individual operations were used by the Auditing Committee in combination during the inspection and audit.

### Brief Data on the Company

*Full official name:* Open Joint-Stock Company North-West Telecom

*Location of the executive body:* 14/26, ul. Gorokhovaya, St. Petersburg, Russia, 181186

*Registration information:* The Company was registered by the Resolution of the Registration Chamber of the St. Petersburg Mayor's Office of 6<sup>th</sup> May 1993, State Registration Certificate No. 2717 of 06.05.93.

**In compliance with the Federal Law On State Registration of Legal Entities and Individual Entrepreneurs, the Company was registered in the Unified State Register of Legal Entities on 17<sup>th</sup> July 2002 under No. 1027809169849.**

The following persons are responsible for book-keeping and making up the accounts and reports of the Company in the audited period:

- Chief Executive officer – V.A. Akulich
- Chief Accountant – M.M. Semchenko.

The general meeting of the shareholders is the supreme management body of the Company. The Board of Directors of the Company consisting of 11 persons was formed.

Chief Executive officer V. A. Akulich was appointed in compliance with Sub-clause 25 of Clause 13.4., Article 13 of the Articles of Association on the basis of the decision of the Board of Directors of 1<sup>st</sup> August 2008 for the term of office till 23<sup>rd</sup> August 2010 inclusive. The terms of the contract of employment with the Chief Executive officer have been approved by the Board of Directors.

The Management Board of the Company was formed on the basis of Sub-clause 27 of Clause 13.4., Article 13 of the Articles of Association by the Board of Directors on 30<sup>th</sup> June 2009, with 11 members and with the term of office from 01.08.2009 till 02.08.2010.

### Key Financial and Economic Indices of the Company's Operation for the year 2009

The following figures that can describe the business activity and the financial standing were achieved by the Company for 2009:

No.	Indices	Unit	2009	2008	Indices Difference, %
1	Returns from sales of goods, jobs, services	RUR million	26,295	24,521	7.23%
2	including income from communication services	RUR million	24,104	22,732	6.03%
3	Prime cost of sold goods, jobs and services	RUR million	23,987	20,638	16.23%
4	including prime cost from communication services	RUR million	23,218	20,076	15.65%
5	Sale profit	RUR million	2,308	3,883	-40.56%
6	Profit before taxes	RUR million	4,406	4,775	-7.74%
7	Net profit	RUR million	3,473	3,622	-4.11%
8	OIBDA	RUR million	7,720	8,062	-4.24%
9	Operation margin	%	8.78%	15.84%	-7.1 PPT
10	Sales profitability	%	9.62%	18.82%	-9.2 PPT

11	Profitability in respect of net profit	%	14.48%	17.55%	3.1 PPT
12	Prime cost per 100 roubles of proceeds	RUR	91.22	84.16	8.39%
13	EBITDA	RUR million	10,818	9,637	12.25%
14	EBITDA margin	%	41.14%	39.30%	1.8 PPT
15	Receipts per line	RUR thousand	5.9	5.5	6.71%
16	Number of lines per employee	pcs.	204	197	3.4%
17	Financial independence ratio	-	0.60	0.58	0.02
18	Net debt (taking into account off-balance leasing and financial investments)/EBITDA	RUR million	1.16	1.60	-27.50%
19	Turnover rate of accounts receivable in respect of operating activity	days	14.58	14.36	1.53%
20	Turnover rate of accounts payable in respect of operating activity	days	36.70	36.82	-0.33%
21	ROIC	%	9.32%	8.20%	1.11 PPT
22	Free CashFlow taking into account financial investments	RUR million	3,863	-8,689	-
23	Profitability of equity capital in respect of net profit	%	10.70%	12.06%	-1.36 PPT

The analysis of the Company's financial reporting allows the Audit Committee to give the following judgement:

- ***A lower level of the N.W.Telecom operations efficiency was caused by the Company's involvement in the implementation of the all-in-one service scheme in the licensed areas, with the expenditure of N.W.Telecom recompensed with earnings from other activities in the amount of RUR 4,282 million.***

Allowing for refunding from the All-in-One Service Fund, the Company's operating profit was RUR 6,591 million in 2009, showing a positive trend (+5.2%) against the level of 2008.

The resulting business performances of the Company are at an acceptable level: the EBITDA growth was 12.3%, with the EBITDA share in the proceeds increasing by 1.8 points to reach 41.1%.

The net profit was RUR 3,473 million, which is -4.1% lower than the 2008 level. The net profit rate of return was 14.5%.

Moreover, disregarding the one off transactions of 2008 (asset sales and revaluation: sale of a 25% interest in CJSC Medexpress and revaluation of the contribution to the authorized capital of CJSC RDPC SvyazisT), the net profit increase was about 26.3%.

- ***The Company may be positioned as an enterprise able to generate a flow sufficient to support its current business, debt service included. In 2009, the free cash flow level was RUR 3,863 million.***
- ***The well-balanced investment policy (investment reduction by 48%, from RUR 13.5 billion to RUR 7.1 billion, and an increased proportion of business development projects from 39% in 2008 to 87% in 2009) and optimized operations of the Company enabled:***
  - ***net debt reduction (incl. off-balance sheet leasing and financial investments) by 18.7%,***
  - ***net debt to EBITDA ratio decreased from 1.6 in 2008 to 1.16,***
  - ***increase of the return on invested capital (ROIC) by 1.11 points to the level of 9.32.***

## Accounts and Reports

Accounting is organized in the Company in compliance with the requirements of the statutory and legal acts regulating the accounting in the Russian Federation, and books and accounts are kept on the basis of the Accounting Policy approved by Order No. 693-prGD of the Company's Chief Executive officer dated 31.12.08 (with amendments and additions approved by the respective order).

The accounts and reports for the year 2009 were prepared in compliance with the Federal Law On Accounting of 21.11.96 No. 129-FZ within the scope of the balance sheet, profit and loss report, annexes to them (forms Nos. 3-5 according to OKUD – All-Russia Classifier of Management Documentation), an explanatory note and an auditor's report confirming the reliability of the accounts and reports. The accounts and reports have been made up on the basis of the reports presented by the Company's branches according to the approved forms.

As a result of the audit of the financial and economic activities of the Company for the year 2009, the Auditing Committee has not established any essential breaches in the observance of the requirements of the RF legislation or any essential deviations in presenting financial or economic transactions.

The accounts and reports of the Company make it possible to have complete and objective information on the financial and economic activities of the Company and their results, required for operations governance and management and for use by investors, creditors, state authorities and other organizations and parties concerned.

## Material Facts of Business (Economic) Activities

Corporate procedures are observed in the Company in compliance with the Corporate Governance Code (approved by the Board of Directors on 22<sup>nd</sup> September 2004 (Minutes of the Meeting No. 33-04) with amendments and additions dated 23<sup>rd</sup> December 2005).

The general rules provided for by the Code are implemented by the Company on the basis of its Provisions and the norms of the current legislation, Articles of Association and bylaws of the Company (*Provisions on the General Meeting of the Shareholders, Provisions on the Board of Directors, Provisions on the Management Board, Provisions on the Committees of the Board of Directors, Provisions on the Information Policy of the Company*).

Information of the Company's observance of the Corporate Governance Code is disclosed in the respective section of the Company's Annual Report. The Auditing Committee did not find in the Company's activities any gross violations of the requirements of the Code, current legislation, Articles of Association or bylaws.

A system of management and control bodies has been formed in the Company, their efficient activities being able to ensure normal development of the Company and the interests of its shareholders. The Board of Directors, Committees of the Board of Directors (*Appointments and Remunerations Committee, Corporate Governance Committee, Strategic Development Committee, and Audit Committee*) have been formed, the Corporate Secretary has been appointed, and the Provisions regulating the procedure of their activities have been approved.

During the year 2009 the Company did not effect any major transactions (in the interpretation of this term by the Federal Law On Joint-Stock Companies).

In 2009 the Company effected some related-party transactions in compliance with the established procedure for making such transactions, and information on such transactions is

disclosed in the Annual Report of the Company. No violations of the prescribed procedure for related-party transactions by the Company's CEO were found.

Information in the form of publications on material facts and on data that might have material impact on the value of the Company's securities was disclosed by the Company in compliance with the procedure provided for by the Provisions on Information Disclosure by Securities Issuers, approved by the Order of the RF Federal Service for Financial Markets No. 06-117/pz-n. dated 10.10.2006. The Auditing Committee has not revealed any facts of breach of the said procedure.

The list of Company's affiliated parties and the changes introduced to the list of the affiliated parties comply with the form set forth in the Provisions on Information Disclosure by Securities Issuers and are published on the Company's web site on a quarterly basis. The Auditing Committee revealed facts of violation of the affiliated parties listing procedure. In the reporting period, the list of affiliates did not include individuals performing the function of the sole executive body of interregional telecommunication companies.

During 2009, the Company provided all-in-one communication services gaining proceeds of RUR 887,000. The Company's losses due to provision of the all-in-one services amounted to RUR 4,327,126,000 in 2009. From the all-in-one service reserve, the Company received a compensation for damages of RUR 3,976,043,000, of which RUR 1,018,442,000 for the 2008 services, and RUR 2,957,601,000 for the 2009 services.

### **Internal Control System**

The goals and principles of the Company's activity internal control system are described in the Provisions on the Internal Control Procedures (System) (approved by the Board of Directors, Minutes No. 16-05 of June 24, 2005 (as amended by Minutes No. 19-01/13(06) of May 17, 2006)), Provisions on the Internal Audit Department, and Provisions on Risk Management in the Company.

The Audit Committee of the Board of Directors deals with internal control through preliminary consideration of certain issues included in the terms of reference of the Board of Directors and preparation of recommendations to the Board of Directors on the matters of external independent audit, accounting (financial) reporting, internal control system, and risk management.

The Audit Committee of the Company's Board of Directors assesses the efficiency of the Company's internal control procedures and provides general supervision and monitoring of the risk management process in general, including the process and the management results for particular, and the most material, risks in the Company. The audit results and the assessment of the Company's risk management procedures are presented to the Audit Committee of the Company's Board of Directors quarterly.

The Internal Audit Department checks the efficiency of the applicable internal control procedures in compliance with the respective regulations. The results of the check are submitted to the Audit Committee once in a quarter.

Risk detection principles and management methods are set forth in the Company's Risk Management Programme approved by the Board of Directors of the Company on 25<sup>th</sup> December 2008 (minutes of the meeting No. 19-01/28(08)). The Company operates in compliance with the approved risk management programme and the existing regulations.

### **Conclusion**

On the basis of the audit procedures, the Auditing Committee believes that the obtained results make it possible to draw a conclusion that

- the decisions on the issues of the financial and economic activities were taken by the Management Board and the Board of Directors of the Company in 2009 in compliance with the then current laws and the Company's Articles of Association,
- the accounts and reports for the year 2009 reliably show in all essential aspects the financial standing of the Company and the results of its financial and economic activities for the period from 1<sup>st</sup> January till 31<sup>st</sup> December 2009,
- and the annual report presented by the Company contains reliable data in its essential provisions, which must be shown according to the law.

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OJSC North-West Telecom

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Members of the Auditing Committee,  
OJSC North-West Telecom

V. V. Bekin

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Secretary of the Auditing Committee,  
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